Supreme Court, U.S.
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No. _____

In The
Supreme Court of the United States
October Term, 1997

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AMBANC LA MESA LIMITED PARTNERSHIP, a partnership

Petitioner,

v.

LIBERTY NATIONAL ENTERPRISES, a partnership,

Respondent.

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On Petition for Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. As a Creditor's Interest in Rents Is Subsumed Within the Value of the Real Property, Should Payment of Net Rents to the Secured Creditor, Therefore, Be Applied to Reduce the Principal Amount of The Secured Claim?

2. Is Substantiality a Factor in Determining Compliance with the Absolute Priority Rule Or Is It Included Within and Duplicative of the Feasibility Test?

LIST OF PARTIES

The parties are the Petitioner, Ambanc La Mesa Limited Partnership, a partnership, Debtor and Debtor-in-Possession in bankruptcy ("Debtor" or "Ambanc"), and Respondent, Liberty National Enterprises, a partnership ("Liberty").

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PETITION FOR WRIT OF CERTIORARI

The Petitioner, Ambanc La Mesa Limited Partnership ("Ambanc"), respectfully requests that fa writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered May 28, 1997.

DISCUSSIONS AND OPINIONS OF LOWER COURTS

On March 30, 1992, after lengthy confirmation hearings, the United States Bankruptcy Court for the District of Arizona entered its Order confirming Ambanc's Plan of Reorganization (the "Order"), In re Ambanc La Mesa Limited Partnership, Ch. 11 Case No. B-90-04918-PHX-RGM, docket at 272, (Bankr. D. Ariz. Mar. 30, 1992). The Order has not been officially reported. The Order is reprinted in the appendix hereto at page 1a along with the Findings of Fact, Conclusions of Law and Order Confirming Plan entered concurrently therewith by the Bankruptcy Court.

The Opinion of the United States District Court for the District of Arizona (the "District Court") affirming the Bankruptcy Court's Order was entered on September 6, 1995, is not reported, but is reprinted in the appendix hereto at page 12a.

The Opinion of the Ninth Circuit Court of Appeals reversing the District Court decision was entered May 28, 1997, is reported at Liberty Nat'l Enter. v. Ambanc La Mesa Ltd. Partnership (In re Ambanc La Mesa Ltd. Partnership), 115 F.2d 650 (9th Cir. 1997), and is reprinted in the appendix hereto at page 30a.

The Order of the Ninth Circuit Court of Appeals denying Ambanc's Petition for Review and rejecting Ambanc's Suggestion for Rehearing *en banc* was entered September 11, 1997, is not officially reported, but is reprinted in the appendix hereto at page 47a.

JURISDICTION

The United States Court of Appeals for the Ninth Circuit filed its Opinion on May 28, 1997, and its Order on Ambanc's Petition for Rehearing on September 11, 1997. The jurisdiction of this Court to review the judgment of the United States Court of Appeals for the Ninth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

1. 11 U.S.C. § 502(b), which provides in pertinent part:

> (b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount. . .

2. 11 U.S.C. § 506, which provides in pertinent part:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs or charges provided for under the agreement under which such claim arose.

3. 11 U.S.C. § 552(b), which provides in pertinent part:

> (b)(1) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits of such property, then such security interest extends to such proceeds, product, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable non-bankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

4. 11 U.S.C. § 1129(b)(2)(A)(iii) which provides:

> (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> (A) With respect to a class of secured claims, the plan provides--
>
> * * *
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

STATEMENT OF THE CASE

On the date the Voluntary Petition for relief under Chapter 11 of the Bankruptcy Code was filed for Ambanc, it owed $8,344,920.00 on a Multifamily Note dated July 15, 1985, now held by Liberty (the "Note"). In response to Debtor's [Ambanc's] Motion for Valuation of Security, the Bankruptcy Court set a value of $4,300,000.00 on the property securing the Note. The secured creditor, Liberty's predecessor-in-interest, did not object and never asked for another valuation of the same or different collateral. The unopposed motion was based on the secured lender's own appraisal which appraiser applied a discounted cash flow analysis of the apartment complex to arrive at the value of the collateral.

In its Plan of Reorganization, Ambanc made provision for payment of the secured amount of the claim of Liberty (Class 4) in full with interest. The Plan further provides for payment in full of the unsecured portion of Liberty's claim (Class 5) without interest. The total to be paid to Liberty approximated the total originally contemplated in the Note within the time frame originally provided by the Note. The remaining classes of creditors provided for by the Plan are as follows:

Class 1	administrative claims;
Class 2	priority claims pursuant to 11 U.S.C. § 507(a)(6) (lessees)
Class 3	priority claims pursuant to 11 U.S.C. § 507(a)(7) (now (8)) (pre-petition taxes)
Class 6	Crain Limited Partnership, a secured creditor junior in position to Liberty
Class 7	general trade creditors
Class 8	Security Savings and Loan Association's unsecured claim
Class 9	contributing limited partnership interests;
Class 10	non-contributing limited partnership interests;
Class 11	Ambanc Management Group, the general partner of Ambanc.

Pursuant to the Plan, Class 6 would make a contribution equal to the amount of its claim, thereby receiving a limited partnership interest. Class 9 claimants would contribute $20,000.00 each, $2,000.00 prior to the Effective Date[1] of the Plan and the remainder in nine annual installments of $2,000.00 each, consistent with the new promissory note executed by each. Class 11 would make a contribution equal to one percent of the total contributions by Class 9 interests, in ten annual installments, beginning on the Effective Date of the Plan.

The Plan provides that Class 1 will be paid in full on or before the Effective Date. Class 2 will be paid in the ordinary course in accordance with the terms of the lease documents. Class 3 priority claims will be paid in full with interest on the Effective Date. The Class 4 secured claim will be paid in full with annual interest of 10.5% over the course of the Plan. Class 5 will be paid the principal amount of its claim in full of $4,044,920.00 without interest. Class 6 will receive no payment on its claim, but will receive a limited partnership interest in the reorganized Debtor. The Class 7 general unsecured claims will be paid 80% of their allowed claims. Class 8 shall be paid 100% of its allowed claim without interest after payment of Classes 1, 3, 4, and 5. The only amount of claims to be discharged under the Plan without payment is 20% of claims of the general unsecured creditors, which totals $5,647.00.

The Class 9 claims will receive, on account of their additional contribution commitments, an interest in the reorganized Debtor. The Class 10 non-contributing limited partners will receive nothing. The Class 11 general partner of the Debtor will receive, on account of the its additional

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[1] The Effective Date of the Plan is defined in the Plan as ". . .the first business day following the last day occurring at least thirty (30) days after which the confirmation order has become final, and non-appealable."

contribution commitments, an interest in the reorganized Debtor.

The Bankruptcy Court approved the Plan. Liberty appealed. The District Court upheld the Bankruptcy Court's Order. Liberty appealed. The Ninth Circuit Court of Appeals reversed and remanded the matter to the Bankruptcy Court and then denied Ambanc's Motion for Reconsideration. The Ninth Circuit Court of Appeals did, however, enter an Order staying issuance of its mandate for sixty days to allow the submission of the instant petition.

During the course of the appeal, Ambanc has consistently been making payments to Liberty. As of November 1, 1997, $2,983,508.95 has been paid to Liberty from net operating income.

Liberty, the successor to the Resolution Trust Corporation ("RTC"), has challenged the confirmed plan on numerous grounds. For example, Liberty contends that the Plan was not proposed in good faith. Liberty also contends that the separate classification was not based on legitimate business reasoning and that the interest rate arrived at by the Bankruptcy Court after an evidentiary hearing was inappropriate. Liberty further contends that the Plan violates the best interest of creditors test. Liberty alleges that the Plan is not fair or equitable, failing to pay the present value of its claim. Liberty argues that the Plan violates the "new value exception" to the absolute priority rule. Finally, Liberty claims that Ambanc's plan is not feasible.

Ambanc continues to believe that there is no merit to any of Liberty's arguments.

The Ninth Circuit Court of Appeals did not reach all of the foregoing issues and, rather, limited its decision to the areas discussed in the instant Petition.

REASONS FOR GRANTING THE WRIT

I. AS A CREDITOR'S INTEREST IN RENTS IS SUBSUMED WITHIN THE VALUE OF THE REAL PROPERTY, SHOULD PAYMENT OF NET RENTS TO THE SECURED CREDITOR, THEREFORE, BE APPLIED TO REDUCE THE PRINCIPAL AMOUNT OF THE SECURED CLAIM?

Ambanc believes that to be consistent with the holding of United Sav. Ass'n of Tex. v. Timbers, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988), under a Deed of Trust and Assignment of Rents, the net rents must be applied to reduce the principal amount of the secured claim.[2]

The Ninth Circuit did not apply the net rents to reduce the principal amount of the secured claim. In fact, the Ninth Circuit did not apply the net rents to even reduce the unsecured claim. The Ninth Circuit actually added the rents to Liberty's portion of the claim when it said:

> The value of Liberty's secured claim for the purposes of confirmation is the market value of real property plus the net amount of the rents collected post-petition and pre-confirmation and subject to a deed of trust and assignment of rents. Thus, Liberty should have been paid on its secured claim of approximately $4.6 million - $4.3 million in the value of the real property and the estimated $300,000 accumulated cash collateral by the time of the effective date. The bankruptcy court erred in finding the $4.3 million valuation of Liberty's secured claim satisfied the cramdown requirements.

Liberty v. Ambanc, 115 F.3d at 654.

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[2] The Ninth Circuit Court of Appeals decision in Ambanc is to be the topic of an article by C. Taylor Ashworth in the next issue of Norton Bankruptcy Law Advisor. It is the Petitioner Ambanc's intention to supplement this brief with the article upon its publication.

The decision of the Ninth Circuit contains no analysis of the issues and ignores the applicability of Sections 502 and 506 of the Bankruptcy Code.

Conversely, the Fifth Circuit in Financial Sec. Assurance, Inc. v. T-H New Orleans Ltd. Partnership) In re T-H New Orleans Ltd. Partnership), 116 F.3d 790 (5th Cir. 1997) has held that the undersecured creditor's allowed claim is to be reduced by the application of the net rents, not increased. The Fifth Circuit does not specify whether the net rents reduce the unsecured claim or the creditor's secured claim. However, the Fifth Circuit specifically reduces the claim with the payments of the net rents.

The Fifth Circuit's decision is diametrically opposed to the Ninth Circuit's decision with respect to the analysis of 11 U.S.C. § 506 and the application of Timbers. As a result, there is a clear split of authority between these two circuits. The different analysis of each circuit is reflected in the ultimate outcome of each case: in Ambanc, Plan confirmation was reversed while in T-H New Orleans, Plan confirmation was upheld.

The interpretation of 11 U.S.C. § 506 and Timbers have long created diverse decisions in bankruptcy courts and district courts throughout the country. This issue has now been treated in two different circuits with divergent results, thereby making a compelling case for resolution by the United States Supreme Court.

The Ninth Circuit's review of the Bankruptcy Court's factual findings is in clear error regarding the Bankruptcy Court's analysis of the value of the secured claim of Liberty. Liberty did not contest Appellee Ambanc's Motion to Value the collateral as the apartment complex at $4.3 million. The secured creditor's appraisal of $4,300,000.00 expressly included in said value the income stream as the discounted cash flow. On the date of the valuation hearing before the Bankruptcy Court, February 11, 1991, there was no cash over and above the monies used to maintain the apartment complex in a commercially reasonable manner. As a result, the

Bankruptcy Court did not err -- the only collateral consisted of the apartment complex which appraisal included the discounted cash flow in the $4,300,000.00 valuation. The Plan anticipated some net cash flow at the time of the Effective Date of the Plan, but this anticipated amount was not in existence at the time of valuation and would have been included in any discounted cash flow analysis. Liberty's predecessor never requested a revaluation of its collateral at the time of plan confirmation.

Recognizing there is a split of authority, to be consistent with the Supreme Court's decision in Timbers, the Debtor believes that the net rents must be applied to reduce the principal amount of the secured claim. The Supreme Court in Timbers held that an undersecured creditor whose collateral is not declining in value is not entitled to adequate protection payments during the pendency of the automatic stay, under 11 U.S.C. § 362(d)(1), and recognized that under 11 U.S.C. § 506(b) an undersecured creditor is not entitled to interest on its claim. Id., 484 U.S. at 376, 108 S.Ct. at 630.

Some courts have criticized the interpretation of Timbers that an undersecured creditor whose collateral is not entitled to either adequate protection or post-petition interest on its claim. The rationale is that this interpretation reads 11 U.S.C. § 552(b) out of the Code. For example, in In re Birdneck Apartment Assocs. II Ltd. Partnership, 156 B.R. 499, 505 (Bankr. E.D. Va. 1993), an undersecured creditor was allowed to apply post-petition payments to interest on its claim. The rationale is that under Section 552 the creditor had a "continuing perfected post-petition security interest in the rents" and that the rental revenue constituted cash collateral as to which the creditor was entitled to adequate protection.

In trying to distinguish Timbers, the Birdneck court said that Timbers only prohibits payments to undersecured creditors from unencumbered assets when there is no evidence that the collateral is declining in value. Birdneck, at 505. Since the rental income in Birdneck was encumbered, payment of interest to the undersecured creditor from that

source was authorized according to the Birdneck court.

It has been determined in other cases that the Birdneck reasoning oversimplifies the issue. In re Kalian, 169 B.R. 503 (Bankr. D. R.I. 1994). In Kalian, the court regarded the Birdneck analysis of Timbers as flawed. The court in Kalian reasoned as follows: although the Supreme Court in Timbers held that under Section 552(b), a perfected security interest in rents continues post-petition, the Timbers court went on to say Section 552(b) makes possession of a perfected security interest in post-petition rents or profits from collateral a condition of having them applied to satisfy the claim of the secured creditor ahead of claims of unsecured creditors. In analyzing the Supreme Court's decision in Timbers, the Kalian Court specifically indicates that it is important to remember that the Bankruptcy Court allowed interest on the undersecured creditor's claim to be paid from post-petition rents in which the creditor had a perfected security interest. If such a result were intended under Section 552(b) the Supreme Court would have had to make that clear. This was not done in Timbers and the Supreme Court has not gone this far. The Kalian court reads Section 552(b) as allowing an undersecured creditor with a perfected security interest in rents to retain that security interest. However, the Kalian court also understands that if the rents are paid to the undersecured creditor while its collateral is not declining in value, which is the case with the La Mesa Village Apartment complex, said rents must be applied to the principal, so as not to render Section 506(b) meaningless. Kalian at 506. As the court in Kalian said:

> To accept Northeast's argument, it would necessarily follow that as the Chapter 11 case progressed, Northeast's security would increase because of its alleged "separate security interest" in the rents while its unsecured deficiency claim decreased. The Supreme Court in Timbers, and common sense suggests that this result was not intended. 484 U.S. at 372, 108 S.Ct. at 630-31. See

also In re Oak Partners, 135 B.R. 440, 450 (Bankr. N.D. Ga. 1991). In discussing whether a secured creditor's right to immediate possession of its collateral upon the debtor's default is an "interest in property" under Section 506(c) the Court said:

> If . . . [the creditor's right to immediate possession of its collateral] were included, 'the value of such creditor's interest' would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues -- since the value of the entitlement to use the collateral from the date of bankruptcy would rise with the passage of time. No one suggests that this was intended.

United Sav. Ass'n. of Texas v. Timbers, 484 U.S. 365, 372, 108 S.Ct. 626, 631, 98 L.Ed.2d 740 (1988).

Kalian at 506.

A secured creditor's interest in collateral which comes into existence post-petition is unequivocally preserved by 11 U.S.C. § 552(b). However, where the amount of an allowed secured claim is at issue, the inclusion of rents should not alter the calculation. If the determination of the value of collateral is made as of the filing date, as required by the language of 11 U.S.C. § 502(b), the creditor's interest in rents is subsumed within the value of the real property and the assignment of rents in a deed of trust does not add to the value of a claim, but only to the collateral therefor.

As Timbers does not answer the foregoing, courts in all circuits continue to grapple with this issue. This Court's decision on the application of rents would resolve continued litigation and inconsistent rulings on this fundamental problem. There have been approximately twenty-eight cases regarding the application of rents under a deed of trust which

provides for the assignment of rents relative to an undersecured claimant. This is not an issue limited to the single asset cases. These cases encompass six or seven approaches to the issue of application of net rents, providing very uneven results and no standard upon which to rely. However, the Ninth Circuit decision in Ambanc personifies the most stringent treatment of any debtor in any jurisdiction to date.[3]

The United States Supreme Court has granted review where there is a conflict among the circuits. See McElroy v. United States, 455 U.S. 642, 643 (1982). The Supreme Court of the United States should grant certiorari in this case to settle the question of the proper application of net rents to an undersecured creditor's claim under of deed of trust and assignment of rents.

As exemplified by the divergent analysis of the Fifth Circuit and the Ninth Circuit and the Birdneck and Kalien courts, it is time for the Supreme Court to tell the Courts how to apply Timbers.

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[3] There are numerous reported cases in this area, including: In re Sherwood Square Assocs., 87 B.R. 388 (Bankr. D. Md. 1988); In re Flagler-at-First Assocs., Ltd., 114 B.R. 297 (Bankr. S.D. Fla. 1990); In re Reddington/Sunarrow Ltd. Partnership, 119 B.R. 809 (Bankr. D. N.M. 1990); In re Landing Assocs., Ltd., 122 B.R. 288 (Bankr. W.D. Tex. 1990); Confederation Life Ins. Co. v. Beau Rivage Ltd., 126 B.R. 632 (N.D. Ga. 1991); In re Oaks Partners, Ltd., 135 B.R. 440 (Bankr. N.D. Ga. 1991); In re Montgomery Apartments, 141 B.R. 324 (Bankr. S.D. Ohio 1992); In re IPC Atlanta Ltd. Partnership, 142 B.R. 547 (Bankr. N.D. Ga. 1992); In re Vermont Inv. Ltd. Partnership, 142 B.R. 571 (Bankr. D.C. 1992); and In re Bloomingdale Partners, 155 B.R. 961 (Bankr. N.D. Ill. 1993).

II. IS SUBSTANTIALITY A FACTOR IN DETERMINING COMPLIANCE WITH THE ABSOLUTE PRIORITY RULE OR IS IT INCLUDED WITHIN AND DUPLICATIVE OF THE FEASIBILITY TEST?

The court below held that under the new value exception to the absolute priority rule, former equity holders were required to offer value which is new, substantial, money or money's worth, necessary for a successful reorganization, and reasonably equivalent to the value or interest retained. The court below also held that the contribution of $320,000.00 over nine years and payment of $32,000.00 on or before the effective date of the Plan, did not meet these criteria.[4]

The new contribution exception derives from Case v. Los Angeles Lumber Prod. Co., 308 U.S. 106, 121, 60 S.Ct. 1, 10, 84 L.Ed. 110 (1939), where the Supreme Court stressed the "necessity, at times, of seeking new money essential to the success of the undertaking from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made." Although the exception was born in *dicta*, it was discussed by the Supreme Court as recently as 1988. See Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 203 n. 3, 108 S.Ct. 963, 967 n.3, 99 L.Ed.2d 169 (1988).

The Ninth Circuit, after Ahlers was decided, adopted the new contribution exception in Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership), 2 F.3d 899, 907-08 (9th Cir. 1993). Likewise, the Sixth Circuit explicitly adopted the new contribution exception in Teamsters

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[4] No one pays money before its time. Over the course of the Plan of Reorganization the Debtor would require working capital. Hence, installments over the course of the Plan ensure a reserve and an on-going source of working capital. Further, there is no basis for a determination that a promissory note is not money or money's worth; it can be bought and sold on the open market.

Nat'l Freight Indus. v. U.S. Truck Co. (In re U.S. Truck Co.), 800 F.2d 581 (6th Cir. 1986).There is nothing in the Ahlers decision to indicate a weakening of the Sixth Circuit's commitment. U.S. Truck and Bonner Mall reflect the view that the creditors' absolute priority can be appropriately vindicated without precluding the continued participation of former owners who alone may have the incentive and skill to make a reorganization succeed. Bonner Mall, 2 F.3d at 916.

The Ninth Circuit in Ambanc utilized the test requiring the contribution to be new, in money or money's worth, substantial, necessary for the reorganization and reasonably equivalent in value to the interest retained. The components of the new value doctrine have not required "substantiality," however.

As stated by the Seventh Circuit:

> The new value precept permits old equity owners to participate in a plan, without full payment to the dissenting creditors, if they make a new contribution (1) in money or money's worth, (2) that is reasonably equivalent to the value of the new equity interests in the reorganized debtor, and (3) that is necessary for implementation of a feasible reorganization plan.[192]

In short, *Case* requires the court measure the owners' proffered contribution against a quality scale. If the contribution possesses the requisite quality, that is, if it is equivalent to money or money's worth, then *Case* requires a second inquiry: Is the contribution worth what is being received; that is, are the contributors getting the debtor on the cheap? The final inquiry is whether the contribution is "necessary."

[192] *In re* Woodbrook Assocs., 19 F.3d 312, 319-320, 30 C.B.C.2d 551, 560 (7th Cir. 1994). Other circuits

> have stated a similar test. In the Ninth Circuit, for example, the contribution must be new; substantial; in money or money's worth; necessary for a successful reorganization; and reasonably equivalent to the value or interest received. Bonner Mall Partnership U.S. Bancorp Mortgage Co. (*In re* Bonner Mall Partnership), 2 F.3d 899, 908, 29 C.B.C.2d 668, 680 (9th Cir. 1993), *cert. granted*, ___ U.S. ___, 114 S.Ct. 681, 126 L.Ed.2d 648 (1994), *motion to vacate denied*, ___ U.S. ___, 115 S.Ct. 386, 130 L.Ed.2d 233 (1994). The only major difference lies in the addition of a substantiality requirement which, as shown at [¶ 1129.04[4][c][iv][D]] *infra* was not originally part of the test and which, in any event, duplicates the feasibility test.

7 Collier on Bankruptcy ¶ 1129.04[4][c][iv] at page 1129-119.

The dispute as to whether substantiality is even a factor in determining whether a proposed plan meets the new value or new contribution exception to the absolute priority rule has arisen in a number of different forums, each analyzing Case differently.

Substantiality appeared as a factor in Official Creditors' Comm. v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.), 781 F.2d 99 (7th Cir. 1986), where a shareholder agreed to fund plan payments of three percent (3%) to unsecured creditors. He also agreed to guaranty certain debt and pay certain administrative claims. Although the Seventh Circuit purported to comply with the standards set out in Case and did apply the "reasonably equivalent" factor, it also included the requirement of substantiality which appeared nowhere in Case.

Although Potter relies on In re Marston Enter., 13 B.R. 514 (Bankr. E.D. N.Y. 1981), and In re Landau Boat Co., 13 B.R. 788 (Bankr. W.D. Mo. 1981), those cases misinterpret Case as requiring substantiality. Marston states merely that Case, "went on to state that such a contribution must be substantial." Landau Boat merely adopted the Marston articulation of the "test".

As to substantiality, however, what the Supreme Court held in Case is:

> Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made. But if these conditions are not satisfied the stockholder's participation would run afoul of the ruling of this Court in *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, supra, that "Whenever assessments are demanded, they must be adjusted with the purpose of according to the creditor his full right of priority against the corporate assets, so far as possible in the existing circumstances." 271 U.S. page 456, 46 S.Ct. page 552, 70 L.Ed. 1028. If, however, those conditions we have mentioned are satisfied, the creditor cannot complain that he is not accorded "his full right of priority against the corporate assets".

Id., 60 S.Ct. at 121.

Other courts have discussed "substantiality" and determined that it is not a requirement. In re Yasparro, 100 B.R. 91, 97 (Bankr. M.D. Fla. 1989) ("Nowhere in [Case v.] *Los Angeles Lumber* did the Supreme Court state the contribution must be 'substantial.'").

> Not only is the substantiality requirement of dubious heritage, but it is unnecessary. A new value plan proponent already bears the burden of demonstrating that the plan is feasible, that is, it will not be followed by

> the need for further financial reorganization. The proponent also has to show that its contribution is necessary. To go beyond these showings and impose a further requirement of a substantial contribution would seem to be imposing a standard that has little relationship to the reorganization of the debtor. In addition, this lack of nexus to reorganization also highlights that the substantiality requirement is a condition on new value proponents which does not seem to be imposed on other potential plan proponents. As such, it would seem not to be useful.
>
> Nevertheless, courts continue to attempt to apply the substantiality requirement, using occasionally what appear to be "gross amount" tests, [footnote omitted] and more often tests based upon the ratio of the amount of the proposed contribution to the amount of the claims affected by the plan. [footnote omitted].

7 Collier on Bankruptcy ¶ 1129.04[4][c][iv][D] at pages 1129-124 - 1129-125.

Alternatively, even if substantiality is a factor to be considered, the Ninth Circuit in Ambanc confused substantiality and what is reasonably equivalent in value to the interest retained. For example, $160,000.00 was found to meet the substantiality test required to apply the new value or new contribution exception to the absolute priority rule, even though $160,000.00 was a small percentage of the unsecured claims of more than $8 million, so long as the $160,000.00 was fairly equivalent to the equity in the real property. In re Economy Lodging Sys., Inc., 205 B.R. 632 (Bankr. N.D. Ohio 1997).

Applying this analysis to the present case, whether $320,000.00 is used in the equation or only $32,000.00 (the first year's contribution), although the initial $32,000.00 cash contribution is a small percentage of the total unsecured claims of approximately $4,376,954.00, it exceeds by at least

$32,000.00 to $320,000.00 the zero equity in the Debtor at the time of confirmation and clearly exceeds the $5,647.00 discharged.

One of the few cases which discusses a formula for calculating the equity is In re Haskell Dawes, Inc., 199 B.R. 867 (Bankr. E.D. Pa. 1996); see also Consolidated Rock Prod. Co. v. DuBois, 312 U.S. 510, 526, 61 S.Ct. 675, 685, 85 L.Ed. 982 (1941) ("Valuations for other purposes are not relevant to or helpful in a determination of that issue [commercial value of property and the expectation of income from it] except, as they may indirectly bear on earning capacity.").

The Haskell Dawes court indicates that two determinations are required. First, the future earnings of the reorganized debtor must be projected, which projections are based not only on past earnings alone, but on factors which may influence income in the future. The Haskell Dawes court recognizes that mathematical precision is neither possible nor required.

The second determination required in Haskell Dawes is that once the earnings are projected, the average annual projected earnings are discounted to present value on the basis of a capitalization rate that reflects the expected annual rate of return that investors would require on an investment of comparable risk. The Haskell Dawes court sets forth how the discounting is to be accomplished, by multiplying the average annual projected earnings by a multiplier that is the inverse of the capitalization rate. The court further notes in relying on In re Future Energy Corp,, 83 B.R. 470, 500-501 (Bankr. S.D. Ohio 1988), quoting Pachulski, *The Cramdown and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C. L. Rev. 925, 938-941 (1980), that the general standard for determining the appropriate capitalization rate is that the capitalization rate should be consonant with the "risk factor" of the particular enterprise, measured largely by its past experiences and the experiences of businesses similarly situated.

In the present case, the Debtor presented the bankruptcy court with sufficient evidence to calculate the capitalized value of its future earnings, so that the court could conclude that the partners proposed contribution was "reasonably equivalent" to their proposed equity interest in the reorganized Debtor. As a result, the Debtor satisfied this last requirement of the new value or new contribution exception. In affirming the Bankruptcy Court's confirmation of the Plan, the District Court specifically noted that the Debtor had satisfied all of the elements. It was the Ninth Circuit that ignored the evidence adduced at trial of plan confirmation and thereby erroneously determined that the last requirement of the new value exception had not been satisfied.

The partners do not reap substantial benefits from the reorganized Debtor. They do not receive payments over the course of the Plan, they do not receive any phantom income or relief from debt, they are not relieved from any personal litigation, as none is pending against them, and they do not receive a salary. As the Ninth Circuit and other courts have observed, new value is not logically distinct from absolute priority:

> The absolute priority rule itself requires that creditors participate in a reorganization in an amount equal to the lesser of their claims or the debtor's reorganization value. [footnote omitted]. In an insolvent debtor, this means that creditors of an insolvent debtor are entitled to property equal to the reorganization value.
>
> The interplay of these relationships means that any contribution of money or money's worth permits owners to retain ownership so long as creditors receive property equal to the debtor's reorganization value. This result obtains, regardless of whether the inquiry starts with the absolute priority rule or *Case's dicta*. In one sense, this is all the creditors could expect. Receipt of an amount equal to reorganization value is

the most creditors could expect outside of bankruptcy or under fraudulent transfer law. Moreover, this value probably represents the maximum amount a third party would pay for the debt-free reorganized company. Regardless of expectations, however, creditors will receive the same amount under the absolute priority rule as under the new value principles.

Recognizing the equivalence between absolute priority and new value principles has critical implications for the relative roles of owners and creditors in business reorganizations. First, owners of an insolvent debtor need not contribute anything to the reorganization if their plan allocates all reorganization value to creditors. [footnote omitted] This means that once their plan allocates all reorganization values to creditors, owners are not at risk for anything other than their original risk capital. Their obligations as owners end. To require otherwise would violate the nonbankruptcy concept of limited liability, and would deviate from the absolute priority rule's origins in fraudulent transfer law. [footnote omitted] As a corollary, owners who do not wish to bid for their debtor may simply walk away, leaving the remains of the debtor to creditors. [footnote omitted] This result is not as harsh as it sounds. In insolvent debtors, plans which cancel all equity interest and issue stock to senior creditors are theoretically sound and comply with the fair and equitable requirement.

Equivalence also has harsh consequences for owners. Allocation of all reorganization value to creditors in the form of reorganization debt leaves a truly valueless residual equity interest. In such circumstances if owners retain the equity interest, confirmation of the reorganization plan may be difficult, if not impossible, without some contribution of additional value. The owner, as mentioned above, must

> show that the postconfirmation debtor will not need "further financial reorganization." [footnote omitted] Cash contributions may be necessary to make this showing, as well as to supply working capital for the reorganized debtor. In short, business needs, not creditor claims, dictate the need for owner contributions.

7 Collier on Bankruptcy ¶ 1129.04[4][c][i][B].

As a result, the contribution required by the Plan reflects an appropriate amount to be paid for the going concern value and the opportunity for potential future profits of an insolvent business.

Since Ahlers was decided, controversies regarding the new value exception to the absolute priority rule, including whether substantiality is a separate factor, continue to frequently arise, as they have in Ambanc. These controversies have been litigated with no further guidance from the Supreme Court. Ambanc believes the Supreme Court's guidance is, therefore, essential.

CONCLUSION

Based on the foregoing, Petitioner respectfully requests that the United States Supreme Court accept its Petition for Writ of Certiorari, reverse the Opinion of the Ninth Circuit Court of Appeals in this case, and that the matter be accordingly remanded with the direction to reinstate the Bankruptcy Court's confirmation Order.

RESPECTFULLY SUBMITTED this 20th day of November, 1997.

DAVIS & LOWE, P.C.

Ilene J. Lashinsky
234 N. Central, #722
Phoenix, AZ 85004
Attorneys for Petitioner

APPENDIX

Order Confirming Debtor's Second Amended Plan of Reorganization of the United States bankruptcy Court for the District of Arizona entered March 30, 1992 . . . . . 1a

Findings of Fact, Conclusions of Law and Order Confirming Plan of Reorganization of the United States Bankruptcy Court for the District of Arizona entered March 30, 1992 . . . . . 3a

Order and *Amended Opinion* of the United States District Court for the District of Arizona filed September 6, 1995 . . . . . .10a

Opinion of the United States Court of Appeals for the Ninth Circuit filed May 28, 1997 . . . . . 28a

Order of the United States Court of Appeals for the Ninth Circuit filed September 11, 1997 . . . . . 45a

APPENDIX "A"

THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF ARIZONA'S ORDER CONFIRMING DEBTOR'S SECOND AMENDED PLAN OF REORGANIZATION

The Second Amended Plan of Reorganization submitted by Debtor, Ambanc La Mesa Limited Partnership came on for approval on March 24, 1992. The Court has reviewed the Plan, all pleadings on file, the evidence and testimony of David Matloff, Elliott Pollack and Thomas Keig, and has considered the objection raised by the Resolution Trust Corporation as Receiver for Western Savings and Loan Association and arguments of counsel for the Debtor and the RTC and for good cause appearing,

IT IS ORDERED confirming the Debtor's Second Amended Plan of Reorganization based upon the Findings of Fact and Conclusion of Law incorporated herein by this reference.

IT IS FURTHER ORDERED that as long as the Reorganized Debtor's obligations pursuant to this Plan are current and not in default, all creditors who are entitled to receive any distribution pursuant to this Plan including but not limited to the Resolution Trust Corporation as Receiver for Western Savings and Loan Association, F.A. shall be enjoined from exercising any and all legal and equitable remedies relating to such claims against the Reorganized Debtor unless and until there is a material, uncured default in the terms of this Plan.

DATED: 3/30/92

/s/Robert G. Mooreman
Robert G. Mooreman
UNITED STATES BANKRUPTCY JUDGE

LODGED this 26th day of
March, 1992:

A copy of the forgoing
was hand-delivered to:

Sean P. O'Brien
Gust, Rosenfeld & Henderson
3300 Valley Bank Center
201 N. Central Ave.
Phoenix, AZ 85073-3300

/s/Ilene J. Lashinsky

Copies of the foregoing mailed
this 30th day of March, 1992 to:

Ilene J. Lashinsky, Esq.
Davis & Lowe
234 N. Central, Ste. 722
Phoenix, AZ 85004

Sean P. O'Brien, Esq.
Gust, Rosenfeld & Henderson
201 N. Central, Suite 3300
Phoenix, AZ 85073-3300

By: /s/ Jeanie Frederick
Deputy Clerk

APPENDIX "B"

THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF ARIZONA'S FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER CONFIRMING PLAN

The Debtor's Second Amended Plan of Reorganization filed April 12, 1991, and incorporated herein by this reference as though fully restated (the "Plan"), pursuant to the provisions of Chapter 11 of Title 11 of the United States Code (the "Code"), having been transmitted to the holders of impaired claims and interest holders and

IT HAVING BEEN DETERMINED AFTER DUE NOTICE TO ALL CREDITORS AND PARTIES IN INTEREST AND A HEARING:

1. Unless otherwise indicated herein, the definitions set forth in Article I of the Plan shall have the same meaning herein.

2. On October 2, 1991, pursuant to Section 1125 of the Bankruptcy Code and Bankruptcy Rule 3017(d), authorized agents of the Debtor began a post-petition solicitation (the "Solicitation") of interest holders and creditors impaired under this Plan by distributing through direct mail to such interest holders and creditors the approved Disclosure Statement, Plan, ballot, and notice of the time within which acceptances and rejections of the Plan must be filed.

3. As reflected in the Supplement to Amended Report on Balloting filed October 24, 1991, incorporated herein by this reference, the Plan was accepted by all classes of Debtor's impaired creditors with the exceptions of Classes 4 and 5. In addition, the Plan was accepted by greater than two-thirds in number of the allowed interests held by of the limited partners who actually voted. At least one impaired class that does not have any alleged insiders accepted the Plan.

4. The classification of claims in the Plan is based upon the substantial similarity of all claims in each such class, is reasonable, was arrived at in

good faith, and was not made for the purposes of affecting the vote in any such class, or for any improper purpose.

5. The solicitation was carried out in good faith, was made to all impaired creditors, was carried on from October 2, 1991 through October 18, 1991.

6. Objections to confirmation of the Plan were to be filed with the Court on or before October 18, 1991. On October 18, 1991, the Resolution Trust Corporation as Receiver for Western Savings and Loan Association ("RTC/Western"), field its objection to the Plan. Such objection cited the provisions of Sections 1129(a)(1), 1129(a)(3), 1129(a)(7), 1129(a)(10), 1129(a)(11), and 1129(b) of the Code and alleged that the Plan does not comply with Section 1129 of the Code.

7. The Disclosure Statement distributed by Debtor to each impaired class of creditors and its interest holders has previously been approved by the Court as containing "adequate information" as required by Bankruptcy Code Section 1125(a).

8. Ambanc La Mesa Limited Partnership is an Arizona limited partnership, which as Debtor and Debtor-in-Possession, owns 256-unit apartment project, known as "La Mesa Village Apartments" (the "Property"), located in Mesa, Arizona at 655 South MEsa Drive, Mesa, Arizona. A copy of the legal description is attached hereto as Exhibit "A" and incorporated herein by this reference.

8. The value of the Property as of the date of the previous order of this Court is $4.3 million.

9. The interest rate on the secured claim of the RTC is set at 10.5%, consistent with the Plan.

10. (a) The Plan complies with all applicable provisions of the Bankruptcy Code and other relevant law;

(b) Debtor complies with all applicable provisions of Title 11, United States Code;

(c) Debtor's Plan has been proposed in good faith and not by any means forbidden by law;

(d) All payments to be made by Debtor or any other party as provided in Bankruptcy Code Section 1129(a)(4) for services or for costs and expenses in or in connection with the case either have been approved, or are subject to the approval, by this Court as reasonable;

(e) As required by Bankruptcy Code Section 1129(a)(5), Debtor has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the Plan, as a director, officer, or voting trustee of the Debtor, and the appointment to, or continuance in, such office of such individuals is consistent with the interests of creditors and equity security holders and with public policy; further, Debtor has disclosed the identity of any insider who will be employed or retained by Reorganized Debtor, and the nature of any compensation for such insider;

(f) The requirements of Section 1129(a)(6) are not applicable to the Plan;

(g) With respect to each impaired class of claims and interests, each holder has either accepted the Plan or will receive or retain under the Plan as of the Effective Date, property of a value that is not less than the amount the interest holder would receive or retain if Debtor were liquidated under Chapter 7 of the Bankruptcy Code;

(h) Each impaired class has either accepted the Plan or the treatment provided by the Plan for such class is fair and equitable and does not discriminate unfairly;

(i) With respect to Class 4, the one class of secured claim, the Plan provides that the holder of such claim shall retain the lien securing such claim to the extent of the allowed amount of such claim, and that the holder of such claim receive on account of such deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the Effective Date of the Plan, of at least

the value of such holder's interest in the estate's interest in such property;

(j) All allowed administrative and priority claims under Sections 503 and 507(a)(1) will be paid in cash in
full under the Plan on the Effective Date or when allowed by order of the Court;

(k) The Plan is feasible and is based on valid business judgments and reasonable estimates of future income. It is not likely to be followed by a liquidation or by a need for further financial reorganization;

(l) The requirements of Section 1129(a)(12) have been complied with by the Debtor;

(m) The requirements of Section 1129(a)(13) are not applicable to this case;

(n) The Plan does not discriminate unfairly among creditors or classes, and the designation of classes under the Plan is reasonable based upon the fact that each claim in any class of the Plan is substantially similar;

(o) All modifications to the Plan do not adversely affect the treatment of claims, creditors or Interest holders under the Plan within the meaning of Bankruptcy Rule 3019 or Section 1127 of the Bankruptcy Code, and the adequate notice of such modifications has been given.

11. All applicable provisions of Section 1129 of the Bankruptcy Code have been met.

12. By the terms of the Plan itself and the record in this case, all agreements, instruments and documents necessary for the implementation of the Plan have been fully disclosed to the Court and have been approved by this Court, and subject to the requirement that they be consistent with the Plan and with this Order.

IT IS THEREFOR, ORDERED, ADJUDGED and DECREED that the Plan as filed on April 12, 1991 is

confirmed;

IT IS FURTHER ORDERED, ADJUDGED and DECREED that the Court shall retain jurisdiction as set forth in Article XIX of the Plan;

IT IS FURTHER ORDERED, ADJUDGED and DECREED that all claims recoverable under Section 550 of the Bankruptcy Code, all claims against third parties on account of any indebtedness, and all other claims owed to or in favor of Debtor to the extent not specifically compromised or released pursuant to the Plan or an agreement referred to and incorporated therein, are preserved and retained for enforcement by Debtor subsequent to the Effective Date;

IT IS FURTHER ORDERED, ADJUDGED and DECREED that the Debtor is authorized and directed to enter into, execute, deliver, and implement the Plan which is incorporated herein by reference, and any and all documents, instruments, and modifications consistent therewith or with the Plan and any amendments to such documents, instruments and modifications being approved hereby, and to take such other steps and perform such other acts, including execution of any other documents or agreements as may be necessary to implement and effectuate the Plan;

IT IS FURTHER ORDERED, ADJUDGED and DECREED that the Additional Contribution Commitments are exempt from registration under the securities law pursuant to Section 1145 of the Bankruptcy Code;

IT IS FURTHER ORDERED, ADJUDGED and DECREED that pursuant to Section 1146(c) of the Bankruptcy Code, the issuance, transfer, or exchange, or the revesting, transfer and sale of any real or personal property of Debtor in accordance with the Plan shall not be taxed under any state or local law imposing a stamp tax, transfer tax, or similar tax.

DATED: March 30th, 1992

s/ Robert G. Mooreman
UNITED STATES BANKRUPTCY JUDGE

LODGED this 26th day of

March, 1992:

A copy of the forgoing
was hand-delivered to:

Sean P. O'Brien
Gust, Rosenfeld & Henderson
3300 Valley Bank Center
201 N. Central Ave.
Phoenix, AZ 85073-3300

/s/ Ilene J. Lashinsky

Copies of the foregoing mailed
this 31st day of March, 1992, to:

Ilene J. Lashinsky, Esq.
Davis & Lowe
234 N. Central, Ste. 722
Phoenix, AZ 85004

Sean P. O'Brien, Esq.
Gust, Rosenfeld & Henderson
3300 Valley Bank Center
201 N. Central Ave.
Phoenix, AZ 85004

By: /s/ Jeanie Frederick
Deputy Clerk

ORDER NUMBER: 86060876-U6

EXHIBIT "A"

THAT PORTION OF THE NORTHWEST QUARTER OF SECTION 26, TOWNSHIP 1 NORTH, RANGE 5 EAST OF THE GILA AND SALT RIVER BASE AND MERIDIAN, MARICOPA COUNTY, ARIZONA, DESCRIBED AS FOLLOWS:

BEGINNING AT THE NORTHWEST CORNER OF SAID SECTION 26; THENCE SOUTH (ASSUMED BEARING) ALONG THE WEST LINE OF SAID SECTION 26, A DISTANCE OF 1567.50 FEET TO THE SOUTHWEST CORNER OF THE PROPERTY DESCRIBED IN DOCKET 12264, PAGE 297, RECORDS OF MARICOPA COUNTY, ARIZONA; THENCE NORTH 899 DEGREES 32 MINUTES 30 SECONDS EAST, PARALLEL WITH THE NORTH LINE OF THE NORTHWEST QUARTER OF SAID SECTION 26 AND ALONG THE SOUTH LINE OF THE PROPERTY DESCRIBED IN DOCKET 12264, PAGE 297, A DISTANCE OF 36 FEET TO THE TRUE POINT OF BEGINNING; THENCE NORTH 89 DEGREES 32 MINUTES 30 SECONDS EAST ALONG SAID SOUTH LINE AND ALONG THE SOUTH LINE OF REPLAT OF HAWS SUBDIVISION, ACCORDING TO BOOK 237 OF MAPS, PAGE 9, RECORDS OF MARICOPA COUNTY, ARIZONA, A DISTANCE OF 1012.12 FEET TO A POINT ON THE WEST LINE OF THAT PARCEL DESCRIBED IN INSTRUMENT RECORDED AT RECORDERS NO. 83 299273, RECORDS OF MARICOPA COUNTY, ARIZONA; THENCE SOUTH 00 DEGREES 09 MINUTES 21 SECONDS EAST, ALONG THE WEST LINE OF SAID PARCEL, A DISTANCE OF 398.33 FEET TO A POINT ON THE NORTH LINE OF CITURS GROVE MANOR, ACCORDING TO BOOK 79 OF MAPS, PAGE 7, RECORDS OF MARICOPA COUNTY, ARIZONA; THENCE SOUTH 89 DEGREES 47 MINUTES 51 SECONDS WEST ALONG SAID NORTH LINE, A DISTANCE OF 1013.18 FEET TO A POINT ONT HE EAST LINE OF THE WEST 36.00 FEET OF THE NORTHWEST QUARTER OF SAID SECTION 26; THENCE NORTH, ALONG SAID EAST LINE, A DISTANCE OF 393.81 FEET MORE OR LESS TO THE TRUE POINT OF BEGINNING;

EXCEPT THAT INTEREST IN AND TO THE WEST 4 FEET THEREOF QUIT-CLAIMED TO THE CITY OF MESA, BY INSTRUMENT RECORDED AT RECORDERS NO. 84 290086.

APPENDIX "C"

THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA'S ORDER

BACKGROUND

The Appellee, Ambanc La Mesa Limited Partnership ("Ambanc"), was formed in June of 1986 to purchase an apartment project known as the La Mesa Village Apartments ("the Property"). In connection with the purchase of the Property, Ambanc executed and delivered a Multi-Family Note dated July 15, 1986 ("Note") in favor of Western Savings in the principal amount of $7,600,000. The Note was secured by a Deed of Trust/Assignment ("Deed of Trust") dated July 15, 1986. RTC/Western ("RTC") is the current holder of the Note and the beneficial interest in the Deed of Trust. RTC's is a properly perfected first and prior lien on the Property. On May 11, 1990, Ambanc filed for bankruptcy under Chapter 11. The Property is Ambanc's sole asset.

On July 20, 1990, the Bankruptcy Court entered an Order granting RTC's Motion to Prohibit Debtor's Use of Cash Collateral ("Cash Collateral Order"). The Cash Collateral Order provides that all rents and revenues generated at the Property are cash collateral pursuant to 11 U.S.C. § 363(a) in which RTC has a properly perfected interest. The Cash Collateral Order further provides that all income from the rents and revenues generated at the Property beyond those necessary to pay the normal operating expenses of the Property are to be segregated by Ambanc in an interest bearing account until further order of the bankruptcy court. See Excerpts of Record ("ER") at 440.

On March 7, 1991, the Bankruptcy Court granted RTC's Motion for Relief from the Automatic Stay and vacated the automatic stay as to the Property. Ambanc appealed the Bankruptcy Appellate Panel's ("BAP") affirmance of the Order. By Opinion filed May 19, 1993, the Ninth Circuit affirmed the bankruptcy court's order, affirmed by the BAP, lifting the automatic stay as to the sole asset of the bankruptcy estate, the Property. See Ambanc v.

RTC, 1993 U.S. App. LEXIS 12828.[1] Thereafter, RTC having made no objection, the Bankruptcy Court entered a Minute Entry Order valuing the Property at $4,300,000.

On April 12, 1991, Ambanc filed a Second Amended Disclosure Statement ("SAD Statement") and Second Amended Plan of Reorganization ("Plan"). The SAD Statement was subsequently modified.

Ambanc's Plan proposed to bifurcate RTC's allowed claim into a secured and unsecured claim based upon the value of the Property. With respect to RTC's secured claim, the Plan proposed to pay RTC over a ten-year period, unless the Property was either sold or the underlying indebtedness refinanced prior to expiration of the ten years. Specifically, the Plan proposed to pay RTC interest-only monthly payments on the principal balance at 10.5% per annum. Any positive cash flow from the Property, to the extent there is any, will be paid to RTC as a principal reduction. The Plan further proposed crediting RTC's cash collateral (estimated at approximately $300,000) as a principal reduction. With respect to RTC's unsecured claim, the Plan proposes to pay RTC out of positive cash flow only after RTC's secured claim is paid in full, over an unspecified amount of time. See ER at 1232, et seq.

The Plan proposed raising capital from its limited and general partners as one source of funding, allowing them to retain all of their partnership interests in Ambanc in return. The Plan's financial projections are based upon an assumed vacancy rate of 250% for the first year, decreasing thereafter to a rate of 8% in the eighth year of the Plan. The Plan also assumes annual increases in gross rental income of 6%.

RTC filed objections to the Plan, claiming that the Plan:

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[1] The Ninth Circuit specifically stated that its ruling could not be construed as reflecting on the merits of the plan which was later confirmed by the Bankruptcy Court.

(1) was not proposed in good faith; (2) failed to list the general partner & its corporate general partners' assets & their respective values; (3) impermissibly gerrymandered certain classes and intentionally impaired certain classes for the improper purpose of obtaining an impaired consenting class; (4) was not feasible; (5) violated the absolute priority rule; (6) unfairly discriminated against RTC; (7) was not fair and equitable.

The Bankruptcy Court conducted evidentiary hearings on the Plan and, on March 30, 1992, entered an order confirming Ambanc's Second Amended Plan of Reorganization. See ER at 390. RTC is appealing from that Order.

ANALYSIS

A. Appellant Fails to Show that the Plan Was Not Proposed in Good Faith

Title 11, Section 1129(a)(3) of the United States Code requires that a plan of reorganization be proposed in good faith and not by any means forbidden by law. There is an independent duty on the part of the bankruptcy court to ascertain that a plan of reorganization complies with this requirement. In re Unichem Corp., 72 B.R. 95, 98 (Bankr. M.D. Ill. 1987).

RTC claims that Ambanc violated this rule by artificially classifying and impairing one unsecured class for the purpose of obtaining an impaired consenting class. The Plan separately classifies the following unsecured claims:

1. Class 5: Unsecured Claim of RTC
2. Class 6: Claim of Crain Limited Partnership
3. Class 7: Claims of Trade Creditors
4. Class 8: Claim of Security Savings & Loan Association

Each class contains unsecured claims. The Trade Creditors are to be paid only 80% of the allowed amount of their respective claims on the effective date of the Plan. RTC accuses Ambanc of deliberately separating these claims and of

deliberately "impairing" the Trade Creditors' Class 7 claims, i.e., paying only 80% rather than the full amount due, in order to create a separate class that would vote for the Plan. Although RTC mentions four separate classes, it appears that the Crain & Security classes did not affirmatively accept the Plan, and RTC focuses only on Classes 5 and 7.

Ambanc, in its responsive brief, discusses only Classes 5 and 7. It states that the classification was not improper because:

1. The creditors are treated differently: Class 5 creditors receive only 80%, but the will receive it immediately, while RTC is to receive 100% over a ten-year period. Ambanc maintains that it did not propose the 80% figure in bad faith; rather, it was a reasonable discount. Had it arranged for 100% immediately, this would have impaired RTC's rights on its secured claim, as the Bankruptcy Code does not permit full payment of an unsecured debt prior to payment of a secured debt.

2. The legal claims are different: RTC's deficiency claim is non-recourse, while Class 5 creditors' claims are not.

In a cramdown[2], a Chapter 11 plan can be confirmed over the objections of one or more impaired[3] classes of claims or interests only if the plan does not "discriminate unfairly" and is fair and equitable with respect to impaired classes that have not accepted the plan.

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[2] The Bankruptcy Code allows a bankruptcy court to confirm a plan of reorganization, in spite of the nonacceptance of the plan by one or more classes of creditors or interest holders. In re Allegheny Intern., Inc., 118 B.R. 282, 304 (Bankr. W.D. Pa. 1990). This process is known as "cramdown".

[3] An interest is impaired unless the plan does not alter the legal, equitable, and contractual rights of the holder of a claim or interest. In Acequia, Inc., 787 F.2d 1352, 1362 (9th Cir. 1986).

Section 1122 of the Bankruptcy Code authorizes classification of claims or interests when those claims are "substantially similar" and when necessary for administrative convenience. 11 U.S.C. §§ 1122(a) and (b); In re Wolff, 22 B.R. 510, 511 (9th Cir. BAP 1982). Appropriate classification of claims is necessary to assure that similar claims are treated similarly and to assure the integrity of the voting process.[4] Matter of Greystone III Joint Venture, 948 F.2d 134, 140 (5th Cir. 1991), cert. denied, __U.S.__, 113 S.Ct. 72 (1992). See also In re Acequia, Inc., 787 F.2d 1352, 1363-64 (9th Cir. 1986). Nevertheless, Section 1122 does not expressly prohibit a plan proponent from placing similar claims in separate classes. A plan proponent has considerable flexibility in classifying claims. See id.

Two standards of review are applied to classification of claims. Classification, such as determining whether "a deficiency claim is legally similar to an unsecured trade claim," is an issue of law, subject to de novo review. Greystone III, 948 F.2d at 140, n.5, 141 n.7. Subsidiary factual findings are, however, entitled to the deference of the clearly erroneous standard. Id. Whether any good business reasons exist to support the debtor's separate classification of claims is a question of fact. Greystone III, 948 F.2d at 141. See also In re Johnston, 140 B.R. 526, 1992 W.L. 119009 (9th

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[4] "Classes must separately vote whether to approve a debtor's plan of reorganization. 11 U.S.C. § 1129(a)(8), (10). A plan may not be confirmed unless either (1) it is approved by two-thirds in amount and more than one-half in number of each 'impaired' class, 11 U.S.C. §1126(c), 1129(a)(8); or (2) at least one impaired class approves the plan, § 1129(a)(10), and the debtor fulfills the cramdown requirements of § 1129(b) to enable confirmation notwithstanding the plan's rejection by one of more impaired classes." Matter of Greystone III Joint Venture, 948 F.2d 124, 137-38 (5th Cir. 1991). A debtor could thus manipulate "acceptance" by artfully placing claims in certain classes.

Cir. BAP 1992); In re Cantonwood Associates Limited Partnership, 138 B.R. 648 (Bankr. D. Mass. 1992).

As the other impaired unsecured classes (Classes 6 & 8) voted against the Plan, RTC does not have standing to assert this claim as to those classes. See Tippet v. Umpqua Shopping Center, Inc. (In re Umpqua Shopping Center, Inc.), 111 B.R. 303, 305 (Bankr. 9th Cir. 1990).

As to the allegation of "gerrymandering" the Trade Creditors' (Class 7) claims, it is clear that, had the Plan provided for immediate payment of 100% of the Trade Creditors' claims, this would have violated the absolute priority rule (see Discussion, infra). Moreover, RTC has presented no evidence that Ambanc could pay 100% at this time. In addition, 20% does appear to be a reasonable discount, and RTC has presented no contrary evidence.

It is well-settled that it is legitimate to pay the relatively small claims of trade creditors more quickly than a large deficiency claim. See In re Le Blanc, 622 F.2d 872, 879 (5th Cir. 1980); In re National Paper & Type Co. of Puerto Rico, 120 B.R. 872, 880 (D. P.R. 1990); In re Sherwood Square Assoc., 107 B.R. 872, 880 (Bankr. Md. 1989). The trade creditors supplied goods and services with the expectancy of short term payment. Prompt payment of such debts promotes good will and enables a debtor to continue to receive goods and services while implementing its recovery. Long term creditors, such as RTC, do not have the same expectations, and it is unfair to classify the trade creditors with such long term creditors as RTC. Again, separate treatment and thus separate classification is appropriate.

Moreover, as Ambanc points out, there is authority for maintaining that the separate voting interests, and the difference in the legal nature of the claims (recourse vs. non-recourse debts) of the two groups were legitimate reasons for separate classification. See Bjolmes Realty Trust, 134 B.R. 1000, 104 (Bankr. D. Mass. 1991); In re Aztec Co., 107 B.R. 585 (Bankr. M.D. Tenn. 1989). While there

is contrary authority, which was cited by RTC, there is no Ninth Circuit authority on this issue, and the Bankruptcy Court was free to find in favor of the Plan.

Reviewing the issues of similarity in priority and legal attributes and the necessity for treatment in separate classes de novo, it appears that the separation of Class 5 and Class 7 was in good faith and was not discriminatory. Ambanc having articulated good business reasons for its decision to place the Trade Creditors and RTC in separate classes, this factual determination must be upheld.

B. The Best Interest Test

RTC claims that the Plan violates 11 U.S.C. § 1129(a)(7) by failing to include a listing of the value of the assets of Ambanc's general partner and its corporate general partner. RTC contends that, as some evidence shows these partners likely have the ability to pay $350,000 to creditors, these are assets which should be disclosed as assets available to liquidation.

Ambanc responds that RTC had ample opportunity in which to obtain this information during its examination of the representative of the Ambanc Management Group. Ambanc further opposes this claim on the ground that RTC has not shown that the assets are relevant to the best interest test, as RTC's claim is non-recourse and could not be pursued against the general partner.

"To satisfy the 'best interest' test embodied in 11 U.S.C. § 1129(a)(7), the debtor must show that a dissenting creditor will receive no less under the plan than it would have received in a Chapter 7 liquidation." In re Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 678 (D.C. Bankr. 1992).

Contrary to RTC's claim, it is not clear that Ambanc's general partner's and its respective corporate general partners' assets would be available to a Chapter 7 trustee for distribution to creditors in the event of liquidation. Section 723(a) of Title 11 of the United States Code

provides that the trustee shall have a claim against a general partner as to claims "with respect to which a general partner of the partnership is personally liable" (emphasis added). As it appears that the loan is non-recourse, and RTC has never made any showing of personal liability, Section 723(a) likely would not apply. See 11 U.S.C. § 1111(b); Aztec, 107 B.R. at 587. Moreover, as Ambanc points out, there is no requirement that such information be included in the Plan. See In re 222 Liberty Assoc., 108 B.R. 971 (E.D. Pa. 1990); In re M. Long Arabians, 103 B.R. 211 (Bankr. 9th Cir. 1989).

RTC has failed to demonstrate that the Bankruptcy Court's confirmation of a Plan omitting general partner information violated the best interest test, and this finding of the Bankruptcy Court will be upheld.

C. "Gerrymandering" Claims

Returning to its allegations of gerrymandering, RTC claims that the Plan impermissibly classifies unsecured classes and intentionally impairs an unsecured class, in violation of 11 U.S.C. § 1122, which provides: "a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."

Again, RTC accuses Ambanc of attempting to create several classes of impaired claims in the hopes that at least one impaired class would vote in favor of its Plan, thus permitting Ambanc to confirm its Plan over RTC's objection. In response, Ambanc cites its response to the "Good Faith" argument previously discussed.

The Court has previously discussed the arguments in relation to RTC's gerrymandering claims. See Discussion, Section A, *supra*. The Court therefore finds, based upon that discussion, that the RTC's gerrymandering claims are without merit.

D. Estimates of Future Income/Feasibility.

Section 1129(a)(11) of Title 11 of the United States Code provides that a plan may be confirmed only if it is feasible, i.e., "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."

The determination of feasibility is a factual determination to be made by the bankruptcy court, and may be overturned only if the bankruptcy court's decision was clearly erroneous. In re Jorgensen, 66 B.R. 104 (Bankr. 9th Cir. 1986); In re Cheatham, 91 B.R. 377 (D. N.C. 1988).

The Plan is based upon Ambanc's projections for rentals on the property. RTC claims that the projections are wildly optimistic and, in reality, there is no likelihood that they will be achieved and that the payments will be made as projected. Thus, RTC argues, the Plan violates 11 U.S.C. 1129(a)(11) as it is not feasible and is likely to be followed by liquidation or further need for financial reorganization. Ambanc argues that the financial projections were supported by the extensive testimony of two experts whose testimony was not refuted.

The proponent of a plan is not required to establish future performance with mathematical certitude. The success of a plan, of necessity, depends on events in the future which can only be estimated and predicted. Cheatham, 91 B.R. at 380. See also Ambanc v. RTC, supra.

During the evidentiary hearings, the Bankruptcy Court heard the testimony of David Matloff and Elliott Pollack concerning the bases for the financial projections. That testimony was to the effect that new construction, market absorption rates, and various other factors would contribute to rental increases within three to four years. RTC did not present any contrary evidence. Instead, it relies upon the past performance on the Property.

The projections, and the Plan upon which they are based, anticipate that recovery will be slow, and that a reasonable time period of ten years may be needed to sell or refinance the property. RTC has not presented any significant evidence demonstrating that this projection is blatantly incorrect.

RTC has not met its burden of demonstrating that the Bankruptcy Court's factual conclusions were clearly erroneous. The Bankruptcy Court's determination that the Plan is based upon reasonable estimates of future income and is feasible is not clearly erroneous, and must be upheld.

E. Fairness and Equity of Plan

The Bankruptcy Code allows a bankruptcy court to confirm a plan of reorganization, in spite of the nonacceptance of the plan by one or more classes of creditors or interest holders. In re Allegheny Intern., Inc., 118 B.R. 282, 304 (Bankr. W.D. Pa. 1990). This process is known as "cramdown." Id. To be confirmed over the objection of a creditor, a plan must not discriminate unfairly and must be fair and equitable with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. 11 U.S.C. § 1129(b)(1).[5]

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[5] In order to "cram down" this Plan over RTC's objections, the Plan must provide one of the three alternative treatments specified in 11 U.S.C. § 1129(b)(2)(A)(i)-(iii). They are:

(i) allowing RTC to retain its liens securing its claim and making deferred cash payments to RTC totaling at least the allowed amount of its claim, with a present value at least equal to the value of its collateral; or

(ii) selling the property, subject to 11 U.S.C. § 363(k), free and clear of RTC's liens, with the liens attaching to the proceeds, and the treatment of liens on the proceeds as set forth in (i) above; or

In order to find that a secured creditor is treated fairly under a plan, the plan must provide that the secured creditor receives deferred cash payments totalling at least the allowed amount of its claim. The deferred payments must have a current value of at least the value of the creditor's interest. 11 U.S.C. § 1129(b)(2)(A)(i)(11).

1. $300,000 Cash Collateral

RTC claims that the Plan applies RTC's cash collateral as a principal reduction, notwithstanding that RTC's secured claim is allegedly equal to the fair market value plus the cash collateral. Thus, it argues, the entire amount of the cash collateral will be improperly "credited" against RTC's secured claim, artificially reducing the total amount of the secured claim.

RTC claims that the Plan thus violates 11 U.S.C. § 1129(b)(2)(A)(i) because it fails to treat RTC's secured claim fairly and equitably. RTC argues that, in order to cram down the Plan, the Plan must provide either that: (1) RTC retain its lien on the cash collateral and receive deferred cash payments equal in value to the cash; (2) the cash be "sold," (concededly impossible), or (3) RTC receive the "indubitable equivalent" of the cash.

RTC contends that the Plan erroneously values RTC's allowed secured claim at $4,300,000, the value of the Property, and completely ignores the accumulated value of RTC's cash collateral which Ambanc estimates is in excess of $300,000.

Ambanc argues that, when the Bankruptcy Court ordered the segregation of the cash collateral, and entered its order that the value of the security held by RTC was $4,300,000, the segregation preserved an estimated $300,000 available to reduce

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(iii) granting RTC the indubitable equivalent of its secured claim.

11 U.S.C. § 1129(b)(A)(i)-(iii).

RTC's claim. The Plan provides that the $300,000 is to be paid to RTC on the effective date of the Plan and credited against RTC's Class 4 secured claim.

RTC has not demonstrated that it is entitled to the additional $300,000 and that the Bankruptcy Court's determination was clearly erroneous. Reversal on this ground is inappropriate.

2. Risks Assumed by the Debtor & its "Financial Family"

RTC claims that the Plan is also inequitable due to its imposition of risk upon the creditors while the debtor's general partners and its affiliated entities derive substantial benefits under the Plan at little or no risk. According to RTC, Ambanc Management Company and Ambanc Limited are, under the Plan, entitled to large fees, while the partners must contribute a mere $20,000 over the life of the Plan in annual increments of $2,000.

Ambanc, however, claims that the capital infusion required of the partners is commensurate with the equity interest they will retain, as they have the opportunity to participate in the future profits of the partnership only after the claims of RTC have been paid in full. Moreover, the management and administrative fees are merely payments for services rendered which would otherwise simply be paid to some other party at a comparable fee. As Ambanc points out, RTC makes no argument that they are unreasonable fees.

As to the objections to payment of the fees, etc., RTC does not provide any convincing authority for its claim that such payments are improper. As this is a factual finding which is not clearly erroneous, the Bankruptcy Court should be upheld.[6]

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[6] RTC's claims in relation to priority will be discussed *infra*, Section G.

3. Discrimination Pursuant to 11 U.S.C. § 1129(b)(1)

As stated above, a Plan may not discriminate unfairly and must be fair and equitable with respect to each class of claims or interests that is impaired under the Plan. 11 U.S.C. § 1129(b)(1). RTC claims that the Plan is unfairly discriminatory by (1) impermissibly gerrymandering unsecured classes and artificially impairing the Trade Creditors' claims and (2) dividing unsecured claimants into four separate classes, all of which are impaired. The Court has addressed these claims, *supra*, Section A, and adopts the reasoning of that section in relation to these claims.

F. Interest Rate

Under the Plan, monthly interest-only payments will be paid on RTC's secured claim at the rate of 10.5% per annum. RTC claims that this is a below-market rate which renders the Plan unfair and inequitable.

Ambanc contends that the Bankruptcy Court properly used a formula method to determine the market rate of interest, and the Bankruptcy Court's conclusions were fully supported by the record. Moreover, RTC did not present any contradictory evidence.

To confirm a plan of reorganization over a secured creditor's objection, the secured creditor must retain its lien and receive deferred cash payments with a present cash value at least equal to the amount of the secured claim. See 11 U.S.C. § 1129(b)(2)(A)(i)(II). In other words, the interest paid on the secured claim must be at a market rate of interest, taking into account all related risks. A bankruptcy court's determination of what factors to apply in a valuation calculation is reviewed de novo. In re Fowler, 903 F.2d 694, 696 (9th Cir. 1990) (citation omitted). A bankruptcy court's application of the various factors governing determination of market rates of interest is a factual determination which is reviewed under the clearly erroneous standard. The district court

should accord substantial deference to the bankruptcy court's determinations. In re Fowler, 903 F.2d 694, 696 (9th Cir. 1990), citing In re Camino Real Landscape Maintenance Contractors, 818 F.2d 1503, 1508 (9th Cir. 1987).

RTC does not contest Ambanc's contention that the bankruptcy court must start with a base rate, either the prime rate or the rate on treasury obligations, and add a factor based on the risk of default and the nature of the security (the "risk factor"). See In re Fowler, 903 F.2d at 697.

The Bankruptcy Court's Order merely states, "[t]he interest rate on the secured claim of the RTC is set at 10.5%, consistent with the Plan." There are no further findings, but RTC does not object on this ground, it merely alleges that the record does not support this conclusion.

The record, however, does support this conclusion. Elliott Pollack testified at the hearing that he used as a base rate the rate for a ten-year treasury note, which was 7.97% at the time he made the computation. See ER at 134. Pollack then made various adjustments to take into account the risk of default and the loan to value ratio. See ER at 135-136, 137.

Contrary to RTC's claim, the record does not show that Pollack or the Bankruptcy Court failed to consider today's commercial lending market. Rather, it shows that a reasonable effort was made to determine a reasonable rate of interest, while acknowledging that obtaining such a loan in today's market would be difficult. The assertion that there is no market for a loan like the plan is not dispositive. Aztec, 107 B.R. at 588. In determining present value, the court's inquiry does not end upon such an assertion. Rather, the court must take such difficulties into account in setting an amount. See id. Thus, in the Aztec case, the reviewing court upheld the bankruptcy court's determination that 200 basis points over applicable Treasury bill rates was sufficient to give the creditor the present value of its allowed secured claim. See also In re Fowler, In re Camino Real.

"A bankruptcy court should be accorded substantial deference in these matters because it has 'almost daily experience with the rates charged by actual commercial lenders and others.'" In re Camino Real, 818 F.2d at 1508, citing In re Fi-Hi Pizza, 40 B.R. 258, 271 (Bankr. D. Mass. 1984). Here, Pollack made an adjustment of 250 basis points. No evidence has been offered by RTC to upset the Bankruptcy Court's factual determination.

G. Absolute Priority Rule

To be fair and equitable with respect to a class of unsecured claims, a plan must provide that:

> (i) each holder of an unsecured claim receive or retain . . . property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B)(i) and (ii). Thus, in the case of an unsecured creditor, "fair and equitable" means that a dissenting class of unsecured creditors must be provided for in full--receiving property equal to the allowed amount of its claims--before any junior class can receive or retain any property under a reorganization plan. In re Bryson Properties, XVIII, 961 F.2d 496 (4th Cir. 1992). This "absolute priority rule" prohibits equityholders from retaining any interests under a plan unless unsecured claims are paid in full. Id.; Ahlers, 485 U.S. at 202.

RTC claims that the Plan violates the absolute priority rule by providing that a partner may retain its partnership interest by paying an additional capital contribution. Under the Plan, the limited and general partners are to make an initial installment of $2,000 prior to confirmation of the Plan with the balance payable in annual $2,000

installments on each anniversary of the effective date of the Plan.

In utilizing this course of action, Ambanc relies on the "new value exception," which allows shareholders "to obtain an interest in the reorganized debtor in exchange for new capital contributions over the objections of a class of creditors that has not received full payment on its claims." Bonner Mall. RTC maintains that the contributions are insufficient and too "speculative" to constitute "new value."

In an opinion issued August 4, 1993, the United States Court of Appeals for the Ninth Circuit ruled that the "new value exception" to the absolute priority rule survived enactment of the Bankruptcy Code. See Bonner Mall, 2 F.3d at 907. The Court may therefore ignore argument within the briefs on that issue and limit its review to application of the "new value exception" to the absolute priority rule.

A proposed plan will not violate the absolute priority rule if the plan satisfies all requirements for the new value exceptions: the former equityholders have offered value that is new, substantial, necessary for successful reorganization, and reasonably equivalent to the value or interest received. Bonner Mall, 2 F.3d at 907-911. Whether a particular plan gives old equity a property interest on account of its old ownership interests in violation of the absolute priority rule or for another, permissible reason is a factual question and thus subject to the clearly erroneous standard. Id.; In re Johnston, 140 B.R. 526, 528 (9th Cir. BAP 1992).

There is no question that the partners' money is "new," nor that it is at least helpful for successful reorganization. RTC argues that the partners' contribution is insubstantial because it consists in large part of a commitment to make future payments, and that it is not reasonably equivalent to the value or interest received.

Ambanc counters that the partners have already contributed a substantial percentage of money required by the Plan. Under the Plan, the total additional capital will be, at a minimum, $320,000. See ER at 1249. Ambanc maintains that this is substantial value sufficient to meet the new value requirement. While it is not a huge amount, RTC has failed to demonstrate that the Bankruptcy Court's determination that this "substantial" was in clear error. See Eaton Hose & Fitting Co., 73 B.R. 139 (Bankr. S.D. Ohio, 1987).

As to whether there is a genuine and fair exchange, under the Plan, a partner may retain its partnership interest only by paying an additional capital contribution. The contributing partners have no right to receive any return on their investment until all the senior classes of creditors have been paid in full under the Plan. In the case of RTC, the Plan provides that it will receive 100% of both its secured and unsecured claims before the partners will receive any payments. This appears to be a genuine and fair exchange of new capital for an equity interest which remains secondary to that of the secured creditors. More importantly, it appears that this arrangement alone may be sufficient to satisfy the absolute priority rule.

Based upon the foregoing discussion, no violation of the absolute priority rule has occurred and the Bankruptcy Court's findings related to this will be upheld.

ATTORNEY'S FEES

RTC asked for attorney's fees. That request will be denied in light of the foregoing order.

CONCLUSION

Having reviewed the Bankruptcy Court's underlying Orders, the complete record in this matter, and having accorded the Bankruptcy Court's legal conclusions de novo review, and reviewing its factual conclusions under a clearly erroneous standard, it is appropriate to affirm the Bankruptcy Court's Order.

IT IS THEREFORE ORDERED affirming the Bankruptcy Court's March 30, 1992 order of confirmation and dismissing this appeal.

FURTHER ORDERED denying RTC's request for attorney's fees.

DATED this 5th day of September, 1995.

/s/Paul G. Rosenblatt
HON. PAUL G. ROSENBLATT
United States District Judge

APPENDIX "D"

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In re: AMBANC LA MESA LIMITED PARTNERSHIP,
Debtor.

LIBERTY NATIONAL ENTERPRISES, a California limited partnership,
Creditor-Appellant,
v.
AMBANC LA MESA LIMITED PARTNERSHIP, an Arizona limited partnership,
Debtor-Appellee.

No. 95-16872
D.C. No. CV-92-00896-PGR
OPINION

Appeal from the United States District Court
for the District of Arizona
Paul G. Rosenblatt, District Judge, Presiding

Argued and Submitted
November 7, 1996—San Francisco, California

Filed May 28, 1997

Before Paul H. Roney,* Robert R. Beezer and Stephen S. Trott, Circuit Judges.

Opinion by Judge Roney

*The Honorable Paul H. Roney, Senior Circuit Judge for the Eleventh Circuit, sitting by designation.

SUMMARY

Bankruptcy/Creditors and Creditors Committees

The court of appeals reversed a judgment of the district court. The court held that an unsecured claim is paid interest before any equity reverts to a bankrupt debtor when the "new value" contributed by former equity holders is *de minimis*.

Appellee Ambanc La Mesa Limited Partnership purchased and operated a 256-room apartment project. Ambanc filed for bankruptcy. Ambanc owed $8.3 million, which was secured by a deed of trust and note on the property held by appellant Liberty National Enterprises (Liberty). The property was valued at only $4.3 million. The bankruptcy court determined that the note owner had a perfected interest in cash collateral from rents and revenue, which it placed in an account.

Over Liberty's objection, the court approved a reorganization plan providing for a class composed of Liberty's $4.3 million secured claim, and for four unsecured classes, including a class composed of Liberty's $4 million unsecured claim. The plan deferred all payments on claims until the effective date. The Plan defined three classes of Ambanc's 16 partners, and provided that they would contribute $20,000, payable over 10 years in annual increments of $2000.

The plan paid no interest on Liberty's secured claim between the plan's confirmation and effective date. On the effective date, the plan offset all of Liberty's accumulated cash collateral, which was predicted to total $300,000, against the $4.3 million principal of its secured claim. After offsetting, the plan paid Liberty interest-only monthly payments at 10.5 percent on the balance of the secured claim. The plan paid principal on Liberty's secured claim if there was positive cash flow and paid the unpaid balance and accrued interest in 10 years. The plan paid Liberty's unsecured claim, without

post-confirmation interest, only if there was sufficient cash flow after Liberty's secured claim was paid.

The district court affirmed the plan. Liberty appealed.

[1] The Bankruptcy Code requires that classes of claims accept a plan or not be impaired by a plan. Liberty, an impaired class, did not accept the plan.

[2] Because that requirement was not met, the Code's "cramdown provision" had to be satisfied. It requires that the plan treat each objecting impaired class fairly and equitably. [3] A plan employs fair and equitable treatment to a secured creditor when deferred cash payments equal the present value at the effective date. The value of Liberty's secured claim for purposes of confirmation was the market value of real property plus rents collected post-petition and pre-confirmation. Liberty should have been paid on its secured claim of $4.6 million—the $4.3 million in the value of the real property and the $300,000 accumulated cash collateral. The $4.3 million valuation of the secured claim did not satisfy the cramdown requirements.

[4] The fair and equitable treatment of unsecured creditors is provided for in the absolute priority rule. The rule prohibits confirmation of a plan if any of the debtor's former equity holders retain any equity interest in the estate without also providing to senior objecting creditors cash or other property equal to the present value of their estate. Ambanc's partners retained equity interest, so Liberty—an unsecured creditor classified senior to Ambanc's partners—had to be paid the present value of its claim. Payment of full value required payment of interest for the post-confirmation time-value of Liberty's unsecured claim. The plan violated the absolute priority rule because it did not pay interest on Liberty's unsecured claim.

[5] Under the "new value corollary," allowing old equity to retain an interest does not violate the absolute priority rule if

the former equity holders provide "new value" to the reorganized debtor.

[6] The corollary requires that former equity holders offer value under the plan that is substantial. The plan provided for an initial contribution of $32,000, and a $320,000 total contribution over 10 years. [7] The relevant amount for the substantiality analysis is the partners' up-front contribution, which was $32,000. [8] The $32,000 was less than 0.5 percent of the total unsecured debt of $4 million. This percentage was well below the percentage of unsecured debt that other courts have held to be insubstantial. In addition, the contribution percentage was likely even smaller when compared to amount of debt discharged—the interest on the unsecured claims. At, for instance, the rate of interest the plan allowed to Liberty's secured claim—10.5 percent—potentially over 10 years, this lost interest could exceed $4 million.

[9] A proposed contribution of 0.5 percent of each of the various quantities judicially recognized as relevant to the substantiality comparison falls within the *de minimis* range.

COUNSEL

Sean P. O'Brien, Frank G. Long, Gust Rosenfeld, Phoenix, Arizona, for the creditor-appellant.

Ilene J. Lashinsky, Davis & Lowe, Phoenix, Arizona, for the debtor-appellee.

OPINION

RONEY, Senior Circuit Judge:

Liberty National Enterprises, the only secured creditor in this single-asset bankruptcy of a 256-unit apartment project,

appeals the confirmation of a Chapter 11 plan of reorganization which utilized the "cramdown" provisions of 11 U.S.C. § 1129(b) of the Bankruptcy Code. We reverse on two grounds.

The bankruptcy court *first*, erroneously failed to include cash collateral, the sum of rents accumulated less operating expenses at the time of the confirmation of the Plan, in the present value securing Liberty's claim; and *second*, violated the absolute priority rule, which would provide interest on that portion of Liberty's claim classified as unsecured before any equity interest would revert to the bankrupt, because the "new value" approved by the court as justifying such a violation was not substantial.

Ambanc is a limited partnership formed in June 1988 to purchase, operate, hold, and ultimately dispose of a single asset: a 256-unit apartment project in Mesa, Arizona. Ambanc purchased the property with funds borrowed from Liberty's predecessor in return for a note in the principal amount of $7.6 million, secured with a deed of trust covering the property. As of May 1990, the Chapter 11 petition date, the amount of the claim secured by the note and deed of trust was $8,344,920. The bankruptcy court valued the real property at $4.3 million. The bankruptcy court also entered an order providing that the RTC, which at that time owned the note, had a properly perfected interest in all rents and revenues gathered at the property, that these funds are cash collateral under 11 U.S.C. § 363(a), and that all net income from the rents and revenues, generated at the property and beyond those necessary to pay the normal operating expenses of the property, are to be segregated by Ambanc in an interest-bearing account. In March 1992, the bankruptcy court confirmed Ambanc's Plan of Reorganization.

THE PLAN

The Plan establishes eight separate classes of creditors: three classes of administrative expense or priority claims; one

class, Class 4, composed of Liberty's secured claim; and four unsecured classes:

Class 5, Liberty's unsecured claim	$4,044,920
Class 6, Crain's unsecured claim	$618,482
Class 7, trade creditors' claims	$28,233
Class 8, Security Savings & Loan Assoc.'s claim	$303,801

The Plan defers all payments on claims until the effective date: the first business day occurring at least 30 days after the confirmation order has become final and nonappealable. Finally, the Plan defines classes 9 through 11, which provide that Ambanc's partners who contribute $20,000, payable over 10 years in annual increments of $2,000, will retain all of their interest in the reorganized debtor.

The Plan treats Liberty's claims as follows. The Plan pays no interest on Liberty's class 4 secured claim between the March 1992 confirmation and the effective date. On the effective date, the Plan will offset all of Liberty's accumulated cash collateral against the $4,300,000 principal of Liberty's secured claim. The accumulated cash collateral was predicted to reach approximately $300,000 by the effective date at the time the Plan was confirmed. After offsetting the cash collateral, the Plan pays Liberty interest-only monthly payments at 10.5% per annum on the balance of the $4,300,000 secured claim. The Plan pays principal on Liberty's secured claim if there is positive cash flow and will pay the unpaid balance and accrued interest in 10 years or if the property is either sold or the underlying indebtedness is refinanced. The Plan pays Liberty's class 5 unsecured claim, without post-confirmation interest, only if there is sufficient cash flow generated after Liberty's class 4 claim is paid in full.

DISPOSITION BELOW

Only class 7 of the impaired classes affirmatively accepted the Plan. The bankruptcy court confirmed the Plan over the

RTC's predecessor's objections. Liberty subsequently obtained the RTC's interest in the note. The district court affirmed more than two years later in September 1995. This appeal followed.

DISCUSSION

On appeal from a final judgment of the district court reviewing a decision of the bankruptcy court, we review the bankruptcy court's factual findings for clear error and the district court's legal conclusions *de novo*. *In re Barakat*, 99 F.3d 1520 (9th Cir. 1996).

I.

The bankruptcy court had an affirmative duty to ensure that the Plan satisfied all 11 U.S.C. § 1129 requirements for confirmation. *In re L & J Anaheim Assoc.*, 995 F.2d 940, 942 (9th Cir. 1993). 11 U.S.C. § 1129(a) sets forth thirteen requirements to be met before the bankruptcy court may confirm a Plan. The bankruptcy court must confirm a Chapter 11 debtor's plan of reorganization if the debtor proves by a preponderance of the evidence either (1) that the Plan satisfies all thirteen requirements of 11 U.S.C. § 1129(a), or (2) if the only condition not satisfied is the eighth requirement, 11 U.S.C. § 1129(a)(8), the Plan satisfies the "cramdown" alternative to this condition found in 11 U.S.C. § 1129(b), which requires that the Plan "does not discriminate unfairly" against and "is fair and equitable" towards each impaired class that has not accepted the Plan. *See In re Arnold and Baker Farms*, 177 B.R. 648 (9th Cir. BAP 1994), *aff'd*, 85 F.3d 1415 (9th Cir. 1996), *cert. denied*, 117 S.Ct. 681 (1997).

[1] The eighth requirement provides that "with respect to each class of claims or interests—(A) such class has accepted the plan; or (B) such class is not impaired under the plan." 11 U.S.C. § 1129(a)(8). 11 U.S.C. § 1129(a)(8) is not satisfied because Liberty, an impaired class, objected.

[2] Because 11 U.S.C. § 1129(a)(8) is not met, the Plan must satisfy the cramdown provision, 11 U.S.C. § 1129(b), to be confirmed. The two requirements for cramdown are that the plan (A) treat each objecting impaired class fairly and equitably, and (B) not discriminate unfairly against any objecting impaired class. 11 U.S.C. § 1129(b)(1). 11 U.S.C. § 1129(b)(2) sets out specific requirements for fair and equitable treatment, which the Plan does not meet in its definition and treatment of Liberty's secured and unsecured claims.

A. Liberty's Secured claim

The 11 U.S.C. § 1129(b)(2) cramdown provision specifies that a fair and equitable plan provide one of three alternatives for the holders of secured claims:

> (i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
>
> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A). Each of these three alternatives prevents Ambanc from cramming down the Plan by paying Liberty less than the present value of the collateral securing its claim.

[3] The Plan purports to employ the first alternative means of fair and equitable treatment. 11 U.S.C. §1129(b)(A)(i)—deferred cash payments equal to the present value at the effective date. The value of Liberty's secured claim for the purposes of confirmation is the market value of real property plus the net amount of the rents collected post-petition and pre-confirmation and subject to a deed of trust and assignment of rents. Thus, Liberty should have been paid on its secured claim of approximately $4.6 million—$4.3 million in the value of the real property and the estimated $300,000 accumulated cash collateral by the time of the effective date. The bankruptcy court erred in finding the $4.3 million valuation of Liberty's secured claim satisfied the cramdown requirements.

B. Liberty's Unsecured Claim

[4] 11 U.S.C. § 1129(b)(2) sets forth specific criteria for the fair and equitable treatment of unsecured claims:

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B). § 1129(b)(2)(B)'s provision for fair and equitable treatment of unsecured creditors codifies the judicially developed absolute priority rule. With one exception, that general rule prohibits the bankruptcy court from confirming the Plan if any of the debtor's former equity holders retain any equity interest in the estate without also providing to senior objecting creditors cash or other property equal to the present value of their claim. Ambanc's partners do retain equity interests, so Liberty—an unsecured creditor classified senior to Ambanc's partners—must be paid the full present value of its claim. The district court found that because Liberty "will receive 100% of both its secured and unsecured claims before the partners receive anything," the Plan satisfied the absolute priority rule. However, in order for Liberty to be paid the full value of its claims, the Plan must provide for payment of interest for the post-confirmation time-value of the amount of Liberty's unsecured claim. *See In re Perez*, 30 F.3d 1209, 1214-15 (9th Cir. 1994). The Plan violates the general absolute priority rule provided in the Code because it does not pay interest on Liberty's unsecured claim.

[5] Because the Plan plainly violates the general absolute priority rule, we must consider whether it satisfies the exception or "corollary," *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *mot. to vacate denied and cert. dismissed*, 115 S.Ct. 386 (1994). Allowing old equity to retain an interest does not violate the absolute priority rule if the former equity holders provide new value to the reorganized debtor, under the "new value corollary" to the absolute priority rule.

[6] The new value corollary requires that former equity holders offer value under the Plan that is (1) new, (2) substantial, (3) in money or money's worth, (4) necessary for successful reorganization, and (5) reasonably equivalent to the value or interest received. *Id.* at 908. Under the Plan, Ambanc's partners retain all of their rights, title, and interest in the reorganized debtor conditioned upon each partner con-

tributing $20,000 payable over 10 years in annual increments of $2,000. With 16 contributors, this translates to an initial contribution of $32,000, and a total contribution of $320,000 over a period of ten years.

There is no dispute that the partners contribute "new" value. We reverse, however, on the ground that the bankruptcy court erred in finding the contribution substantial, the analysis of which is intertwined with the "money or money's worth" component.

The bankruptcy court's findings of fact, conclusions of law and order confirming the Plan stated only that "[e]ach impaired class has either accepted the Plan or the treatment provided by the Plan for such class is fair and equitable and does not discriminate unfairly." Order ¶ 10(h). We find this conclusion to be clear error. *See Bonner*, 2 F.3d at 909.

[7] The relevant amount for the substantiality analysis is the partners' up-front contribution. Under the "money or money's worth" requirement, the new capital contribution of the former equity holders (1) must consist of money or property which is freely traded in the economy, and (2) must be a present contribution, taking place on the effective date of the Plan rather than a future contribution. *See In re Yasparro*, 100 B.R. 91, 96-97 (Bankr. M.D. Fla. 1989) (holding that promissory notes from the individual debtor to the unsecured creditors were future rather than present contributions and thus did not satisfy the new value corollary) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988); *In re Stegall*, 85 B.R. 510 (C.D. Ill. 1987), *aff'd*, 865 F.2d 140 (7th Cir. 1989)). Only those contributions from Ambanc's partners that will actually be paid on the effective date of the Plan may be considered as money or money's worth under the new value corollary—the contribution of $32,000.

The *Bonner* case was before this Court on the district court's reversal of the bankruptcy court's grant of relief from

the automatic stay. The bankruptcy court had based relief from the stay on its conclusion that the new value corollary to the absolute priority rule was no longer in effect. In affirming the district court's reversal, we first determined that the judicially-created new value corollary survived the enactment of the Bankruptcy Code in 1978. We then held that the specific record before us did not establish as a matter of law that there was no reasonable possibility that the bankruptcy judge could find the plan at issue "fair and equitable." In *Bonner*, there had not yet been a confirmation hearing on the reorganization plan, under which old equity was to contribute $200,000, or 6% of the unsecured debt of $3.4 million. We noted that there are "certain conceptual difficulties regarding valuation inherent in the application of the new value exception," *id.* at 917 n.40, but deferred addressing valuation methodology until we might be presented with a concrete factual situation at a later date, *id.*

The present case still does not present us with the factual situation appropriate for the resolution of the difficult issues of valuation in the context of the new value corollary. Rather, we reject the contribution proposed here as a threshold matter because it is *de minimis* as a matter of law.

The most conceptually difficult prong of the new value corollary may be the fifth—equivalence, which likely requires the bankruptcy court to determine a value for the reorganized debtor to be compared with the contribution. Wholly *de minimis* contributions, however, simply fail the threshold analysis under the second prong, substantiality—a requirement separate and independent of equivalence. *see In re Snyder*, 967 F.2d 1126, 1131 (7th Cir. 1992). Commentators have observed that "prior to making the time-consuming determination as to whether the new value contribution is reasonably equivalent to the value being received[—the equivalence prong], a significant number of courts have required that the new value contribution be 'substantial' in comparison to such things as" (1) the total unsecured claims against the

debtor, (2) the claims being discharged, or (3) the dividend being paid on unsecured claims by virtue of the contribution. J. Ronald Trost, Joel G. Samuels, Kevin T. Lantry, *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, CA46 A.L.I.-A.B.A. 479, 552 (1995).

[8] There is no dividend being paid as a result of contribution in this case, and we need not now determine whether total unsecured claims or total amount discharged provides the better basis, because the contribution in this case is *de minimis* under either comparison. First, $32,000 is less than 0.5% of the total unsecured debt of approximately $4 million. This percentage is well below the percentage of unsecured debt that other courts have held to be insubstantial as a matter of law. *Compare, e.g., In re Woodbrook Assocs.*, 19 F.3d 312, 320 (7th Cir. 1994) ($100,000 contribution not substantial because it is only 3.8% of $2.6 million unsecured debt); *In re Snyder*, 967 F.2d 1126, 1132 (7th Cir. 1992) ("the disparity between the contribution and the unsecured debt," at most $22,000 or 2.2% of approximately $1,000,000 unsecured claims, was "so extreme . . . there [was] no need to proceed any further . . . ."); *and In re Olson*, 80 B.R. 935 (Bankr. C.D. Ill. 1987) ($5,000, or only 1.56% on the $320,000 due all unsecured creditors, held insubstantial), *aff'd*, No. 88-4052, 1989 WL 330439 (C.D. Ill. Feb. 8, 1989), *with In re Elmwood, Inc.*, 182 B.R. 845 (D. Nev. 1995) ($150,000, less than 4% of unsecured debt, approved where a higher contribution would not correct the undesirable location and crime problems associated with the primary asset, an apartment complex). Second, the contribution percentage is likely even smaller when compared to amount of debt discharged—the interest on the unsecured claims. At, for instance, the rate of interest the Plan applies to Liberty's secured claim—10.5%—potentially over ten years, this lost interest could exceed $4 million.

Rejection of *de minimis* contributions is consistent with longstanding precedent. The absolute priority rule arose in the

early part of this century from litigation attacking collusion between shareholders and bondholders who sought to squeeze-out unsecured creditors in reorganizations of failed railroads. Bruce A. Markell. *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*. 44 Stan.L.Rev. 69 (Nov. 1991). The courts initially employed fraudulent transfer principles to assist unsecured creditors. *Id.* at 76-77. In one early such case, *Northern Pacific Ry. v. Boyd*. 228 U.S. 482 (1913), the Supreme Court recognized two general principles: First, continued shareholder participation in the reorganized debtor creates a presumption of collusion. *Id.* at 507. Second, reorganization managers could dispel this presumption by promulgating a "fair" offer to all creditors. *Id.* at 508. Our holding in *Bonner* recognizes that such precedential heritage survived the later codification of the absolute priority rule. The *Boyd* presumption against former equity's participation has endured as a primary component of absolute priority jurisprudence. A *de minimis* contribution is insufficient to overcome that presumption.

[9] We decline to define a bright-line rule, but merely hold that a proposed contribution of one-half of one percent of each of the various quantities judicially recognized as relevant to the substantiality comparison falls within the *de minimis* range.

Based upon the above holding, we need not reach the fourth and fifth prongs of the new value corollary, necessity and reasonable equivalence. However, if a new Plan is proposed in the future and confirmed, the bankruptcy court's confirmation order will likely need to exhibit a more comprehensive factual determination as to necessity than is present in the order under review. The court must also take care that the equivalence analysis only compares what the partners put in to what they get out.

II.

There are two additional confirmation requirements that will merit closer consideration by the bankruptcy court if a

new Plan is put forth following remand. First, the tenth 11 U.S.C. § 1129(a) confirmation requirement provides:

> If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

11 U.S.C. § 1129(a)(10). Liberty argues that the Plan unfairly discriminates against Liberty by making repayment of its unsecured class 5 claim conditional, while paying the trade creditors' class 7 claims in cash on the effective date of the Plan. Liberty contends that the only basis for paying the trade creditors 80% at the Plan's inception was to gerrymander an impaired class to vote for the Plan.

Discrimination between classes must satisfy four criteria to be considered fair under 11 U.S.C. § 1129(b): (1) the discrimination must be supported by a reasonable basis; (2) the debtor could not confirm or consummate the Plan without the discrimination; (3) the discrimination is proposed in good faith; and (4) the degree of the discrimination is directly related to the basis or rationale for the discrimination. *In re Wolff*, 22 B.R. 510, 511-12 (9th Cir. BAP 1982). Moreover, separate classification for the purpose of securing an impaired consenting class under § 1129(a)(10) is improper. *See In re Greystone III Joint Venture*, 995 F.2d 1274, 1279 (5th Cir. 1991), *cert. denied*, 506 U.S. 821 (1992), and *cert. denied*, 506 U.S. 822 (1992); *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990). In affirming on this element, the district court reasoned that "it is legitimate to pay the relatively small claims of trade creditors more quickly than a large deficiency claim" because "[p]rompt payment of such debts promotes good will and enables a debtor to continue to receive goods and services while implementing its recovery." On the other hand, the continued services of ordinary tradespeople may not always be a commercial necessity for an apartment operator in a large metropolitan area with many other providers of

those services. *See In re Barakat*, 173 B.R. 672, 681 (Bankr. C.D. Cal. 1994) *aff'd*, 99 F.3d 1520 (9th Cir. 1996); *In re Lumber Exchange Ltd. Partnership*, 125 B.R. 1000 (Bankr. D. Minn.), *aff'd*, 134 B.R. 354 (D. Minn. 1991), *aff'd*, 968 F.2d 647 (8th Cir. 1992). If confirmation is reconsidered on remand, the trade creditors' payoff issue must be resolved by specific evidence and court findings therefrom based upon the four *Wolff* factors.

Second, under the best interests test, where not all creditors support the Plan, the debtor must prove that the creditors would receive as much under the Plan as they would receive in a liquidation under Chapter 7, 11 U.S.C. § 1129(a)(7). While we do not reverse on this issue, we note that if confirmation is reconsidered after remand, the bankruptcy court must make specific findings to determine whether each claim holder in the impaired classes would receive no less under the Plan than they would have received in a Chapter 7 proceeding. *Kane v. Johns-Manville Corp.*, 843 F.2d 636, 649 (2d Cir. 1988); *In re M. Long Arabians*, 103 B.R. 211 (9th Cir. BAP 1989) (remanding Plan to bankruptcy court for findings on 11 U.S.C. § 1129(a)(7) when "the court did not have a proper factual basis to make an informed decision").

III.

Finally, the bankruptcy court did not clearly err in determining that the Plan is feasible on the evidence before it. *See In re Jorgensen*, 66 B.R. 104 (9th Cir. BAP 1986) (determination of feasibility is a factual determination).

CONCLUSION

Neither Liberty's secured nor its unsecured claim was treated fairly and equitably to allow cramdown. The secured claim should have included the cash collateral. The unsecured claim was not given absolute priority over the partners' inter-

ests, and the partners' contribution was too insubstantial to satisfy the new value corollary.

Liberty's request for attorney's fees in this matter is denied.

REVERSED.

APPENDIX "E"

NINTH CIRCUIT COURT OF APPEALS' ORDER

Before: RONEY,* BEEZER, and TROTT, Circuit Judges.

The panel as constituted above has voted to deny the petition for rehearing. Judge Trott has voted to reject the suggestion for rehearing en banc. Judges Roney and Beezer so recommend.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote on it. Fed. R. App. P. 35(b).

The petition for rehearing is DENIED and the suggestion for rehearing en banc is REJECTED.

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* The Honorable Paul H. Roney, Senior United States Circuit Judge for the Eleventh Circuit, sitting by designation.

Supreme Court, U.S.
FILED
JAN 5 1998
CLERK

(2)

No. 97-915

In The

Supreme Court of the United States

October Term, 1997

AMBANC LA MESA LIMITED PARTNERSHIP,
a partnership,

Petitioner,

v.

LIBERTY NATIONAL ENTERPRISES, a partnership,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the accumulated rents of $300,000 constitute part of Liberty's secured claim for purposes of determining whether the Plan satisfies 11 U.S.C. § 1129(b)(2).

2. Whether substantiality is an independent element of the new value exception or corollary to the absolute priority rule.

PARTIES TO THE PROCEEDING

The Petition for Writ of Certiorari accurately lists the parties to the proceeding. Respondent Liberty National Enterprises ("Liberty") is a closely held California limited partnership which has no parent company or any subsidiaries or affiliates.

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OPINIONS OF LOWER COURTS

After several evidentiary hearings the United States Bankruptcy Court for the District of Arizona ("Bankruptcy Court") issued a Minute Entry dated March 24, 1992 confirming Ambanc La Mesa Limited Partnership's ("Debtor") Second Amended Plan of Reorganization ("Plan") and directing Debtor's counsel to lodge a separate confirmation order consistent with the ruling. (E.R. 268A) The Minute Entry has not been officially reported and is reprinted in the appendix hereto at page A.1. In all other material respects the Petition for Writ of Certiorari accurately reflects the opinions delivered in this case by other courts.

STATUTES INVOLVED

11 U.S.C. § 1129(b) which provides:

> (b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.
>
> (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements;

(A) With respect to a class of secured claims, the plan provides:

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims –

(i) The plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests –

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

In all other material respects the Petition for Writ of Certiorari accurately reflects the statutes involved.

STATEMENT OF THE CASE

Liberty hereby incorporates the facts recited in its opening brief and the subsequent Opinion issued by the Ninth Circuit.

With regard to Debtor's Statement of the Case, Liberty disputes certain of the factual recitations as incomplete or inaccurate. Specifically, by Order dated March 8,

1991, the Bankruptcy Court valued *only* the real property securing Liberty's claim at $4,300,000 (E.R. 108).

Debtor improperly references the certain new promissory notes allegedly executed by the Class 9 claimants. Petition, p. 7. However, no such promissory notes are part of the record below or were offered into evidence by Debtor at any of the evidentiary hearings.

Debtor erroneously states that the only claims discharged under its Plan are $5,647.00. Petition, p. 7. Debtor, however, acknowledges that Liberty's Class 5 claim will only be paid the principal amount of its claim *without interest*. Petition, p. 7. The Ninth Circuit concluded that the amount of the debt discharged under the Plan included, *inter alia*, the interest on Liberty's Class 5 claim which was not paid under the Plan. *Ambanc*, 115 F.3d at 656. The Ninth Circuit in *Ambanc* reasoned:

> At, for instance, the rate of interest the Plan applies to Liberty's secured claim – 10.5% – potentially over ten years, this lost interest could exceed $4 million.

Ambanc, 115 F.3d at 656.

Debtor improperly asserts that the Ninth Circuit reversed and remanded the matter to the Bankruptcy Court. Petition, p. 8. In actuality, the Ninth Circuit simply reversed the Confirmation Order *without* remanding the matter to the Bankruptcy Court. *Ambanc*, 115 F.3d at 657.

REASONS WHY THE PETITION FOR WRIT OF CERTIORARI SHOULD BE DENIED

I. THE ACCUMULATED RENTS OF $300,000 CONSTITUTE PART OF LIBERTY'S SECURED CLAIM FOR PURPOSES OF DETERMINING WHETHER THE PLAN SATISFIES 11 U.S.C. § 1129(b)(2)

Debtor erroneously asserts that *Ambanc* is inconsistent with *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740 (1988).[1] Unlike *Ambanc*, however, *Timbers* did not address the issue of whether a plan of reorganization satisfied the cram down standards of 11 U.S.C. § 1129(b)(2). *Timbers* arose in the context of a secured creditor's motion for relief from the automatic stay. *Timbers* did not address the issue of valuation of a secured claim pursuant to 11 U.S.C. § 506(a) or how to treat accumulated rents in valuing the secured claim for purposes of cram down. Rather, *Timbers* dealt with the discrete issue of whether a undersecured creditor was entitled to post-petition interest on its collateral during the stay to assure adequate protection. *Timbers*, 484 U.S. at 369.[2] This simply was not an issue on appeal in *Ambanc*. Thus, to the extent that it is even relevant, *Timbers* is not inconsistent with *Ambanc*.

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[1] *Timbers* was not cited by either the District Court or the Ninth Circuit.

[2] In *Timbers* the respondent debtor "had agreed to pay petitioner the post-petition rents from the apartment project (covered by the after acquired property clause in the security agreement), minus operating expenses." *Timbers*, 484 U.S. at 368-69. Thus, the debtor in *Timbers* sought the "use value" of the property in addition to the post-petition rents.

Timbers did, however, implicitly recognize that an assignment of rents represents a security interest which is separate and distinct from the mortgage on the real estate and that each interest deserves adequate protection. *Timbers*, 484 U.S. at 374. Other courts have been more explicit in recognizing the separateness of the two security interests. *See, In re Gramercy Twins Associates*, 187 B.R. 112 (Bankr. S.D.N.Y. 1995) (post-petition payments by the debtor to the secured creditor should not be applied against the secured portion of the claim; rather, payments must be considered protection for the separate interest in rents in accord with § 552(b) and be credited only against the total allowed amount of the claim, indirectly reducing the unsecured portion of the claim); *In re Bloomingdale Partners*, 155 B.R. 961 (Bankr. N.D. Ill. 1993) ("taken together, sections 506(a) and 552(b) require that [the creditor's] post-petition security interest in rents be added to its separate security interest in the Property"); *Federal Nat'l Mortgage Ass'n v. Dacon Bolingbrook Assoc. L.P.*, 153 B.R. 204 (N.D. Ill. 1993) (Fannie Mae possesses a distinct, additional interest in the rents which must be adequately protected from a reduction in value); *In re Vermont Inv. Ltd. Partnership*, 142 B.R. 571 (Bankr. D.D.C. 1992) (because the mortgage and assignment of rents were distinct interests of the creditor, payments made pursuant to a cash collateral order designed to protect an assignment of rents should not be deducted from the creditor's secured claim); *In re Financial Ctr. Assocs. of East Meadow, L.P.*, 140 B.R. 829 (Bankr. E.D.N.Y. 1992) (creditor entitled to adequate protection of two distinct interests; its mortgage on the property and its right to collect rents flowing from the property or, at the very least, its security

interest in such rents); *In re Flagler-at-First Assocs.*, 114 B.R. 297 (Bankr. S.D. Fla. 1990) (post-petition payments pursuant to a cash collateral order should not be deducted from the amount of the secured claim because the secured creditor was entitled to protection of its separate interests in the property and the rents). Consistent with this line of cases, *Ambanc* simply added the value of the security interest in the real property ($4,300,000) and the value of the separate security interest in the accumulated rents ($300,000) to arrive at a value for Liberty's secured claim ($4,600,000) for purposes of cram down.

Debtor erroneously asserts that there is a split of authority between the Ninth Circuit in *Ambanc* and the Fifth Circuit in *In re T-H New Orleans Ltd. Partnership*, 116 F.3d 790 (5th Cir. 1997). There is no such split of authority. Debtor asserts that these circuit courts differ in their analysis of 11 U.S.C. § 506 and the application of *Timbers*. Petition, p. 10. This is nothing more than Debtor's fundamental misunderstanding of both the facts and the holding in *T-H New Orleans*.[3] Like *Ambanc*, *T-H New Orleans* held that the amount of a secured claim is not limited to the petition date – post-petition rents increase the amount of the secured claim.[4] *T-H New Orleans*, 116 F.3d at 798. In

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[3] The Fifth Circuit in *T-H New Orleans* noted that "the Timbers Court was not confronted with the question we are presented today. We note that the creditor in Timbers was undersecured at the time of its adequate protection hearing and the appeal to this Court, and the value of the collateral was not increasing and there was no evidence that future appreciation would provide for post-petition interest." *T-H New Orleans*, 116 F.3d at 797.

[4] Unlike *Ambanc*, the secured creditor in *T-H New Orleans* was receiving post-petition pre-confirmation monthly cash

doing so, the Fifth Circuit in *T-H New Orleans* adopted a "flexible approach" and declined to follow a narrow approach limiting the value of a secured claim to a single point in time. *T-H New Orleans*, 116 F.3d at 798. The Fifth Circuit in *T-H New Orleans* reasoned that a flexible approach to valuing a secured claim recognizes that any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, and not the debtor. *T-H New Orleans*, 116 F.3d at 798; *See also, Dewsnup v. Timm*, 502 U.S. 410, 417, 112 S. Ct. 773, 778, 116 L. Ed. 2d 903 (1992) (any increase over the judicially determined valuation during the bankruptcy rightly accrues to the benefit of the creditor, not the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor – mortgagee bargain). As to this discrete issue, *Ambanc* and *T-H New Orleans* are not "diametrically opposed." The mere fact that *Ambanc* resulted in the reversal of a confirmation order and that *T-H New Orleans* resulted in the affirmance of a confirmation order does not suggest otherwise.

Debtor incorrectly assumes that Liberty's separate perfected security interest in the accumulated rents is necessarily subsumed within the value of the real property. Petition, p. 13. The fact that a prior appraisal utilized a discounted cash flow analysis fails to support this conclusion. The appraisal was dated as of July 20, 1990 and Debtor readily acknowledges that the accumulated rents of $300,000 "[were] not in existence at the time of the

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collateral payments. These cash collateral payments were then subtracted from the secured creditor's *allowed* claim.

valuation." Petition, p. 11. Thus, the accumulated rents could not possibly be subsumed within the value of the real property. To hold otherwise, or to adopt the anomaly proposed by Debtor (i.e., simply add the value of the accumulated rents to the collateral for the secured claim *rather than* to the value of the secured claim) would be to render both 11 U.S.C. §§ 506(a) and 552(b) practical nullities and theoretical absurdities.

Whether or not Liberty requested a revaluation of its collateral at the time of confirmation is immaterial. First, there was no dispute that as of the effective date of the Plan there was approximately $300,000 in accumulated rents. (E.R. 165, at p. 30) Thus, there was no reason to request an additional valuation hearing simply to determine the undisputed value of the accumulated rents. Second, Liberty objected to confirmation of Debtor's Plan on the ground that, *inter alia*, the Plan was not fair and equitable having failed to take into account Liberty's separate perfected security interest in the accumulated rents. Debtor had the burden to prove by a preponderance of the evidence that its Plan satisfied all the requirements of 11 U.S.C. § 1129, including the cram down standards. *In re Arnold and Baker Farms*, 177 B.R. 648 (9th Cir. BAP 1994), *aff'd*, 85 F.3d 1415 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 681 (1997). The Bankruptcy Court had an affirmative duty to ensure that the Plan satisfied all 11 U.S.C. § 1129 requirements for confirmation. *In re L&J Anaheim Assoc.*, 995 F.2d 940, 942 (9th Cir. 1993). Debtor failed to carry its burden and the Bankruptcy Court similarly failed to discharge its duty.

The only inconsistency is the position asserted by Debtor with respect to the date for valuing a secured

claim for purposes of cram down and the particular Bankruptcy Code provision governing this analysis. In October, 1990 Debtor filed a Motion for Valuation of Security ("Motion") seeking a valuation of the real property. (E.R. 51) A copy of the Motion is reprinted in the Appendix hereto at page A.4. The Motion, relying on 11 U.S.C. § 506(a) as its statutory predicate, states:

> It has been said that the value of the subject property should be determined as of the date to which the valuation relates. *For example, if the valuation is to determine the amount of a secured claim for purposes of a Chapter 11 plan of reorganization, the value should be determined as of, or close to, the effective date of the plan.*

A.7 (emphasis added). The Motion further states that the appraisal[5] "more closely approximates in time the effective date of the plan, which is currently anticipated as early 1991 and, therefore, more accurately depicts the value of the real property." A.7. Conspicuously absent in the Motion is any reference by Debtor to 11 U.S.C. § 502(b) and valuing the secured claim as of the petition date. The Motion is wholly inconsistent with Debtor's argument that the value of the secured claim should be determined as of the petition date. Debtor should be estopped from now asserting a contrary position before this Court.

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[5] The appraisal was dated as of July 20, 1990. The bankruptcy petition was filed May 30, 1990.

II. SUBSTANTIALITY IS A RECOGNIZED AND INDEPENDENT ELEMENT OF THE NEW VALUE EXCEPTION OR COROLLARY TO THE ABSOLUTE PRIORITY RULE

The Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *mot. to vacate denied and cert. dismissed*, 115 S. Ct. 386 (1994) adopted the new value exception or corollary to the absolute priority rule.[6] At the time *Bonner Mall* was the first circuit court decision to hold that the new value exception or corollary survived the enactment of the Bankruptcy Code. Since then the Seventh Circuit in *In re Matter of 203 N. LaSalle St. Partnership*, 126 F.3d at 955 (7th Cir. 1997) has also adopted the new value exception or corollary. Both *Bonner Mall* and *203 N. LaSalle St. Partnership* held that the new value exception or corollary requires that equity holders provide value to the reorganized debtor that is (1) new, (2) substantial, (3) in money or money's worth, (4) necessary for a successful reorganization, and (5) reasonably equivalent to the value or interest received. *Bonner Mall*, 2 F.3d at 908; *203 N. LaSalle St. Partnership*, 126 F.3d at 963. Both circuit courts have recognized substantiality as a separate

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[6] The Court has summarized the absolute priority rule as follows:

> "[A] dissenting class of unsecured creditors must be provided for in full before any junior classes can secure or retain any property under a reorganization plan."

Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202, 108 S. Ct. 963, 966, 99 L. Ed. 2d 169 (1988) (internal quotation marks and brackets omitted).

and independent element of the new value exception or corollary.

Ambanc merely applied the recognized elements of the new value exception or corollary, including the substantiality element, to the facts of the case. In doing so, *Ambanc* held that only the $32,000 capital contribution made by the equity holders on the effective date of the Plan satisfied the money or money's worth element. *Ambanc*, 115 F.3d at 655. In evaluating the substantiality element *Ambanc* rejected the $32,000 capital contribution as a threshold matter because it was *de minimis* as a matter of law in comparison with any of the various quantities judicially recognized as relevant. *Ambanc*, 115 F.3d at 655, 656. Accordingly, *Ambanc* expressly declined to reach the necessity and reasonable equivalence elements of the new value exception or corollary.[7] *Ambanc*, 115 F.3d at 656.

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[7] Notwithstanding, *Ambanc* went on to briefly address both the necessity and reasonable equivalence elements:

> However, if a new Plan is proposed in the future and confirmed, the bankruptcy court's confirmation order will likely need to exhibit a more comprehensive factual determination as to necessity than is present in the order under review. The court must also take care that the equivalence analysis only compares what the partners put in to what they get out.

Ambanc, 115 F.3d at 656. Based on the record (or lack of record) it is clear that the Ninth Circuit would have reversed on these two elements and certain other independent confirmation requirements were there any reason to reach them.

The elements of the new value exception or corollary, including the substantiality element, have been developed through a substantial body of case law, relying in large part upon dicta from *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 2d 110 (1939). *203 N. LaSalle St. Partnership*, 126 F.3d at 963; *Bonner Mall*, 2 F.3d at 906. The Court in *Case* held that the plan of reorganization proposed by the debtor was not fair and equitable as a matter of law. Nonetheless, the Court in *Case* went on to discuss certain circumstances under which existing stockholders may participate in a plan of reorganization of an insolvent debtor. The Court in *Case* firmly established the rule of absolute priority. Since *Case*, a substantial body of case law including *Bonner Mall*, *Ambanc* and *203 N. La Salle St. Partnership* has evolved holding that substantiality is one of the independent elements of the new value exception or corollary.[8]

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[8] *In re Woodbrook Assocs.*, 19 F.3d 312, 320 (7th Cir. 1994); *In re Snyder*, 967 F.2d 1126 (7th Cir. 1992); *In re U.S. Truck Co., Inc.*, 800 F.2d 581 (6th Cir. 1986); *In re Potter Material Serv., Inc.*, 781 F.2d 99 (7th Cir. 1986); *Berkeley Federal Bank & Trust v. Sea Garden Motel and Apartments*, 195 B.R. 294 (D.N.J. 1996); *In re Elmwood, Inc.*, 182 B.R. 845 (D. Nev. 1995); *Coones v. Mutual Life Ins. Co.*, 168 B.R. 247 (D. Wyo. 1994), *aff'd* 56 F.3d 77 (10th Cir. 1995); *In re BMW Group I*, 168 B.R. 731 (Bankr. W.D. Okla. 1994); *In re Wynnefield Manor Assocs.*, 163 B.R. 53 (Bankr. E.D. Pa. 1993); *In re Capital Center Equities*, 144 B.R. 262 (Bankr. E.D. Pa. 1992); *In re Sovereign Group 1985-27, Ltd.*, 142 B.R. 702 (E.D. Pa. 1992); *In re SLC Ltd. V*, 137 B.R. 847 (Bankr. D. Utah 1992); *In re Pullman Construction Industries, Inc.*, 107 B.R. 909 (Bankr. N.D. Ill. 1989); *In re Ashton*, 107 B.R. 670 (Bankr. D.N.D. 1989); *In re Kendavis Indus. Int'l, Inc.*, 91 B.R. 742 (Bankr. N.D. Tex. 1988).

Debtor erroneously contends that even if substantiality is an element of the new value exception or corollary then "the Ninth Circuit in *Ambanc* confused substantiality and what is reasonably equivalent in value to the interest retained." Petition, p. 19. Quite the contrary, *Ambanc* expressly held that "[w]holly *de minimis* contributions, however, simply fail the threshold analysis under the second prong, substantiality – *a requirement separate and independent of equivalence.*" *Ambanc*, 115 F.3d at 655 (emphasis added); *See also, In re Snyder*, 967 F.2d 1126, 1131 (7th Cir. 1992). *Ambanc* went on to further note that rejection of *de minimis* contributions is consistent with long standing precedent including railroad reorganizations dating back to the early part of the century. *Ambanc*, 115 F.3d at 656. It is Debtor, rather than the Ninth Circuit, which has confused the substantiality element with the reasonable equivalence element.

Debtor's reliance on *In re Haskell Dawes, Inc.*, 199 B.R. 867 (Bankr. E.D. Pa. 1996) is misplaced. *Ambanc* had no reason to even reach the reasonable equivalence element of the new value exception or corollary as the $32,000 capital contribution was *de minimis* as a matter of law and failed to satisfy the substantiality element. Ironically, the bankruptcy court in *Haskell Dawes* denied confirmation of the plan of reorganization based upon the debtor's failure to satisfy the substantiality element of the new value exception or corollary. Indeed, the factors considered by the bankruptcy court in *Haskell Dawes* included, *inter alia*, the size of the capital contribution, its relation to the amount of unsecured claims against the estate and the

amount of the debt to be discharged. *Haskell Dawes*, 119 B.R. at 9875. The bankruptcy court in *Haskell Dawes* concluded that the mathematical relationship of these various factors neither compelled a finding of substantiality nor lack of substantiality. *Haskell Dawes*, 199 B.R. at 876. In stark contrast, however, the mathematical relationship of these various factors compelled the Ninth Circuit in *Ambanc* to find that the $32,000 capital contribution was *de minimis* as a matter of law and failed to satisfy the substantiality element.[9]

CONCLUSION

For all the foregoing reasons, Respondent respectfully urges the Court to deny the Petition for Writ of Certiorari.

Respectfully submitted,

RICHARD A. SEGAL
SEAN P. O'BRIEN
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201 N. Central Avenue, Suite 3300
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(602) 257-7460

Counsel for Respondent

[9] The Ninth Circuit in *Ambanc* declined to define a bright-line rule but instead held that the $32,000 capital contribution, which equates to less than one half of one percent of each of the various quantities judicially recognized as relevant to the substantiality comparison falls within the *de minimis* range. *Ambanc*, 115 F.3d at 656.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA
MINUTES

(Filed Mar. 24, 1992)

BANKRUPTCY JUDGE: ROBERT G. MOOREMAN
CLERK: LU ANN BELLER
COURT REPORTER: MONICA TURNER
NO./ADV.NO.: 90-4918-PHX-RGM

NAME: AMBANC LA MESA LTD PARTNERSHIP CH 11

SUBJECT OF HEARING: 1. CONTINUED HEARING ON MOTION FOR APPROVAL OF APPLICATION FOR ALLOWANCE & PAYMENT OF ATTORNEYS FEES FOR COUNSEL FOR APPELLEE FEES $9048.50 & COSTS $ -0- 2. EVIDENTIARY HEARING ON CONFIRMATION OF PLAN

DATE/TIME: MARCH 24, 1992, 2:00 PM, HEARING ROOM 1

APPEARANCES:

ATTY RTC: SEAN O'BRIEN
ATTY DEBTOR: ILENE LASHINSKY/EDWARD DAVIS

PROCEEDINGS:

RTC'S EXHIBIT K was marked for identification. EXHIBITS E, F, G, and H were admitted into evidence.

DEBTOR'S EXHIBIT 17 was marked for identification.

THOMAS PATRICK KEIG was sworn and examined by Mr. O'Brien. Ms. Lashinsky crosses. Mr. O'Brien re-directs and Ms. Lashinsky re-crosses.

ELLIOTT DAVID POLLACK was sworn and examined by Ms. Lashinsky as a rebuttal witness. Mr. O'Brien responded.

COURT: IT IS ORDERED TAKING THIS MATTER UNDER ADVISEMENT.

IT IS FURTHER ORDERED DIRECTING MR. O'BRIEN TO FILE AN ANSWER TO THE RESPONSE REGARDING THE APPEAL ON THE APPLICATION FOR FEES NOT LATER THAN TUESDAY, MARCH 31, 1992.

AMBANC LA MESA 90-4918

UNDER ADVISEMENT RULING

THE COURT HAVING HAD UNDER ADVISEMENT THE MATTER OF CONFIRMATION OF THE DEBTOR'S PENDING PLAN OF REORGANIZATION AND AFTER TRIAL THEREON, AND AFTER DUE CONSIDERATION OF ALL MATTERS PRESENTED THEREON INCLUDING ALL PLEADING THEREON, THE EVIDENCE, TESTIMONY AND EXHIBITS AS WELL AS MEMOS AND ORAL ARGUMENTS ALL UNDER THE PRESENT POSTURE OF THE CASE, THE COURT FINDS AND CONCLUDES THAT THE DEBTOR HAS MET ALL THE REQUIREMENTS FOR CONFIRMATION OF THE PLAN UNDER THE BANKRUPTCY CODE AND THAT THE PENDING PLAN SHALL BE CONFIRMED. IT IS THEREFORE ORDERED CONFIRMING THE PENDING PLAN IN ALL RESPECTS INCLUDING BUT NOT LIMITED TO THE PLAN'S INTEREST RATE OF 10.5% WHICH THE COURT ADOPTS HEREIN AND THE VALUATION OF THE $4.3 MILLION SUBJECT APARTMENT PROJECT. IT IS THEREFORE ORDERED CONFIRMING THE PLAN AND DIRECTING THE DEBTOR TO LODGE A SEPARATE CONFIRMATION ORDER CONSISTENT HEREWITH, FORTHWITH, WHICH WHEN SIGNED, FILED

AND DOCKETED SHALL BE THE FINAL APPEALABLE ORDER HEREIN.

/s/ Robert G. Mooreman
Robert G. Mooreman
Chief U.S. Bankruptcy Judge

Copies of the foregoing mailed March 25, 1992 to:

Ilene Lashinsky/Edward Davis, Atty Debtor
Sean O'Brien, Atty RTC
U.S. Trustee

By: Jeanie Frederickson
Deputy Clerk

DAVIS & LOWE, P.C.
LAWYERS

234 N. CENTRAL AVENUE
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PHOENIX, ARIZONA 85004
(602) 253-2882

Edward E. Davis, #000985
Ilene J. Lashinksy, #003073

Attorneys for Debtor

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re AMBANC LA MESA LIMITED PARTNERSHIP, an Arizona Limited Partnership, Debtor.	Chapter 11 Proceeding Case No. B-90-4918 PHX RGM **DEBTOR'S MOTION FOR VALUATION OF SECURITY**

Ambanc La Mesa Limited Partnership, an Arizona limited partnership (the "Debtor"), by and through undersigned counsel, respectfully moves this Court pursuant to 11 U.S.C. §506 and Bankruptcy Rule 3012 to determine the value of the security held by Western Savings and Loan Association now the Resolution Trust Corporation ("Western" or "RTC"). The security at issue consists of certain improved real property with the legal description attached hereto as Exhibit "A" and incorporated herein by this reference. Said real property consists

of a 156-unit apartment project known as "La Mesa Village Apartments" located in Mesa, Maricopa County, Arizona at 655 South Mesa Drive.

In support of its Motion, the Debtor alleges and states:

1. Western Savings and Loan Association filed a Motion for Relief from the Automatic Stay on June 18, 1990. Pursuant to said Motion, it has sought relief from the automatic stay with respect to the above-described real property known hereafter as "La Mesa Village Apartments".

2. The RTC through its Motion, Western has asserted certain claims that are allegedly secured by a lien on the subject real property in which this estate has an interest.

3. Debtor contends that the value of the real property equals $4,300,000.00 and that any indebtedness of the Debtor to Western should be determined by this Court to be in said amount.

4. A copy of Bankers Real Estate Consultants, Inc. appraisal dated July 20, 1990, provides that the value of the security held by the RTC is $4,300,000.00. A copy of said appraisal is attached hereto as Exhibit "B" and incorporated herein by this reference.

5. This Motion is supported by the Memorandum of Points and Authorities attached hereto and incorporated herein by this reference.

WHEREFORE, Debtor respectfully requests this Court to determine the value of the subject real property

is $4,300,000.00 and for such other and further relief as this Court deems appropriate under the circumstances.

Respectfully submitted this 19th day of October, 1990.

DAVIS & LOWE, P.C.

By: /s/ Ilene J. Lashinsky
Edward E. Davis, Esq.
Ilene J. Lashinsky, Esq.
234 North Central, Ste 722
Phoenix, AZ 85004
Attorneys for
Ambanc La Mesa
Limited Partnership

MEMORANDUM OF POINTS AND AUTHORITIES

Bankruptcy Rule 3012 provides as follows:

> "Valuation of Security. The Court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest and after a hearing on notice to the holder of the secured claim and any other entity as the Court may direct".

The value of the security of the secured creditor should be determined pursuant to 11 U.S.C. §506(a). Section 506(a) provides, in pertinent part:

> "[S]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan effecting such creditor's interest".

Western has utilized in its Motion for Relief from Automatic Stay a prior appraisal in the sum of $5,000,000.00. Debtor believes that the recent appraisal, attached hereto as Exhibit "B" prepared by Bankers Consultants more accurately depicts the value of the property and places the issue of valuation squarely before the Court as ripe for determination. The issue of valuation is absolutely essential for plan purposes.

It has been said that the value of the subject property should be determined as of the date to which the valuation relates. For example, if the valuation is to determine the amount of a secured claim for the purposes of a Chapter 11 plan of reorganization, the value should be determined as of, or close to, the effective date of the plan. 3 *Colliers on Bankruptcy* (edition 15, 1990) ¶ 506.04 pages 506-537.

In the present situation, the appraisal relied on by the RTC is over 12 months old as its effective date was January 22, 1990. On the other hand the appraisal of Bankers Real Estate Consultants, Inc. was prepared recently with an effective date of July 20, 1990. It is anticipated that the plan of reorganization and disclosure statement will be filed within one or two weeks of the date of this motion and that the Bankers Real Estate Consultants, Inc. appraisal more closely approximates in time the effective date of the plan, which is currently anticipated as early 1991 and, therefore, more accurately depicts the value of the security and the secured claim of the RTC.

WHEREFORE, Debtor respectfully requests the Court to determine the value of the subject real property to be

$4,300,000.00 and for such other and further relief as this Court deems appropriate under the circumstances.

Respectfully submitted this 19th day of October, 1990.

DAVIS & LOWE, P.C.

By: /s/ Ilene J. Lashinsky
Edward E. Davis, Esq.
Ilene J. Lashinsky, Esq.
234 North Central, Ste 722
Phoenix, AZ 85004
Attorneys for
Ambanc La Mesa
Limited Partnership

A copy of the foregoing was delivered/mailed on 19th day of October, 1990, to:

U.S. Trustee
320 N. Central Ave.
Phoenix, AZ 85004

Sean P. O'Brien
Gust, Rosenfeld & Henderson
3300 Valley Bank Center
Phoenix, AZ 85073
Attorneys for RTC

/s/ Ilene J. Lashinsky

(3)

Supreme Court, U
FILED
JAN 19
CLERK

No. 97-915

In The
Supreme Court of the United States
October Term, 1997

AMBANC LA MESA LIMITED PARTNERSHIP, a partnership

Petitioner,

v.

LIBERTY NATIONAL ENTERPRISES, a partnership,

Respondent.

On Petition for Writ of Certiorari
to the United States Court of Appeals
for the Ninth Circuit

REPLY TO BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

ILENE J. LASHINSKY, ESQ.
Counsel of Record
DAVIS & LOWE, P.C.
234 N. Central, #722
Phoenix, AZ 85004
602-253-2882

Attorneys for Petitioner

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99 L.Ed.2d 169 (1988) 3

REASONS FOR GRANTING THE WRIT

I. AS A CREDITOR'S INTEREST IN RENTS IS SUBSUMED WITHIN THE VALUE OF THE REAL PROPERTY, SHOULD PAYMENT OF NET RENTS TO THE SECURED CREDITOR, THEREFORE, BE APPLIED TO REDUCE THE PRINCIPAL AMOUNT OF THE SECURED CLAIM?

Petitioner Ambanc La Mesa Limited Partnership ("Ambanc") indicated in its Petition at page 9 n. 2 that it intended to supplement its brief with a copy of a discussion of the issues raised by the Ninth Circuit's decision in Liberty Nat'l Enter. v. Ambanc La Mesa Ltd. Partnership (In re Ambanc La Mesa Ltd. Partnership), 115 F.2d 650 (9th Cir. 1997), in particular the application of rents. Therefore, reprinted in the appendix hereto, beginning at page 1a, is "Postpetition Rents and Valuing the Secured Claim: the Circuits Speak" by C. Taylor Ashworth, published in the Norton Bankruptcy Law Advisor.

The Editor's Note to the Ashworth article is by special counsel to Respondent Liberty National Enterprises ("Liberty"), Randolph Haines.

This article highlights the disparate decisions across the country and in certain circuits on this issue and that a decision from the United States Supreme Court is essential for uniformity on treatment of payments to undersecured creditors on issues not raised in the case of United Sav. Ass'n of Tex. v. Timbers, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988)

II. IS SUBSTANTIALITY A FACTOR IN DETERMINING COMPLIANCE WITH THE ABSOLUTE PRIORITY RULE OR IS IT INCLUDED WITHIN AND DUPLICATIVE OF THE FEASIBILITY TEST?

After preparation of Ambanc's Petition for Writ of Certiorari, the Seventh Circuit decided In re 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997). As noted in Liberty's Brief for Respondent in Opposition to Petition for Writ of Certiorari ("Opposition"), 203 N. LaSalle adopted the substantiality requirement as part of the new value corollary to the absolute priority rule of 11 U.S.C. § 1129.

What is not noted by Liberty is that it is clear from the facts in 203 N. LaSalle that if Ambanc had been a case in the Seventh Circuit, rather than in the Ninth Circuit, confirmation of Ambanc's Plan would have been affirmed.

In 203 N. LaSalle, the principal amount owed the secured creditor was $93,000,000 on property whose value was held to be $55,800,000, leaving an unsecured deficiency claim of $37,200,000. The principals of the debtor agreed to infuse $3,000,000 on the day after the effective date and $625,000 annually for a total capital contribution of $6,125,000 having a present value of $4,000,000. The Seventh Circuit included all payments, including future installments, whereas the Ninth Circuit ignored the future installments totalling $288,000. Thus, the Seventh Circuit determined that the $4,000,000 constituted 10.7% of the $37,200,000 unsecured deficiency claim of the secured creditor.

Since the unsecured trade creditors were no worse off than in a Chapter 7 (receiving 100% of their claims without interest) and the secured creditor was better off than in a Chapter 7 (receiving 16% of its deficiency claim instead of nothing), the Seventh Circuit determined that the 10.7% contribution was substantial and met the new value corollary to the absolute priority rule. The confirmation of the 203 N. LaSalle Plan was affirmed.

As argued in Ambanc's Petition, even if substantiality is a factor, Ambanc's Plan met this factor. Petition at page 19. In Ambanc's Plan, the principal amount owed the secured creditor was $8,300,000 on property valued at $4,300,000 leaving an unsecured deficiency claim of $4,044,000. The principals of Ambanc agreed to infuse $32,000 prior to the effective date and $32,000 per year for nine years for a total capital contribution of $320,000. The $320,000 represents 7.9% of the $4,044,000 unsecured deficiency claim of Liberty.

Since the unsecured trade creditors are no worse off than in a Chapter 7 (receiving 80% of their claims without interest) and the secured creditor is better off than in a Chapter 7 (receiving 100% of its deficiency claim instead of nothing), the 7.9% contribution is substantial and meets the new value corollary to the absolute priority rule.

The Seventh Circuit's analysis emphasizes the disagreement between the Circuits on how to define or test substantiality, if it is a factor, in meeting the new value exception to the absolute priority rule. As Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) left these issues open, it is appropriate and important to settle these post-Ahlers controversies by accepting certiorari.

CONCLUSION

Based on the foregoing, Petitioner respectfully requests that the United States Supreme Court accept its Petition for Writ of Certiorari, reverse the Opinion of the Ninth Circuit Court of Appeals in this case, and that the matter be accordingly remanded with the direction to reinstate the Bankruptcy Court's confirmation Order.

RESPECTFULLY SUBMITTED this 27th day of January 1998.

DAVIS & LOWE, P.C.

Ilene J. Lashinsky
234 N. Central, #722
Phoenix, AZ 85004-2215
Attorneys for Petitioner

APPENDIX

Postpetition Rents and Valuing the Secured Claim: The Circuits Speak by C. Taylor Ashworth . . . 1a

APPENDIX "A"

POSTPETITION RENTS AND VALUING THE SECURED CLAIM: THE CIRCUITS SPEAK

by C. Taylor Ashworth, Esq.
OSBORN MALEDON, P.A.
Phoenix, Arizona

I. INTRODUCTION

After years without any guidance from the circuits, suddenly both the Ninth and Fifth Circuits announce important decisions on the valuation of undersecured claims in Chapter 11 cases. *In re Ambanc La Mesa Limited Partnership*, 115 F.3d 650 (9th Cir. 1997); *In re T-H New Orleans*, 116 F.3d 790 (5th Cir. 1997). They address an issue that has divided the bankruptcy courts: whether rents accumulated during the course of a chapter 11 case should be added to the value of the real property to determine the amount of the secured claim. Without elaboration of its reasoning, the Ninth Circuit reversed the confirmation of a Chapter 11 plan because the amount of the undersecured claim failed to include accumulated postpetition rents. The Fifth Circuit upheld confirmation of a plan that paid the secured creditor interest from the point in time its claim became oversecured as a result of both an increase in value of the real property and a decrease in amount of the claim due to postpetition adequate protection payments. Both cases adopt the view the amount of a secured claim is not limited to the petition date--postpetition rents increase the amount of the secured claim.

In *Ambanc*, the conclusion was apparently based on the "value, as of the effective date" language of § 1129(b)(2)(A)(i), but the Court offered no analysis of this language in support of its conclusion: "The value of [the secured creditor's] secured claim for the purposes of confirmation is the market value of the real property plus the net amount of the rents collected post-petition and pre-confirmation and subject to a deed of trust and

assignment of rents." 115 F.3d at 654. *T-H New Orleans* noted the existence of authorities holding that secured claims should be valued as of the petition date, but engaged in no statutory interpretation to reach its result:

> We decline to follow such a narrow path [of a single valuation date]. Therefore, we conclude that for purposes of determining whether a creditor is entitled to accrue interest under § 506(b) in the circumstance where the collateral's value is increasing and/or the creditor's allowed claim has been or is being reduced by cash collateral payments, such that at some point in time prior to confirmation of the debtor's plan the creditor may become oversecured, valuation of the collateral and the creditor's claim should be flexible and not limited to a single point in time, such as the petition date or confirmation date.

116 F.3d at 798. The only justification provided by the Fifth Circuit was that its "flexible approach" "recognizes that any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, and not to the debtor." It did not identify any basis for the assumption that appreciation belongs to the creditor.

For those of us in the trenches, the resolution of these issues *ought* to be a welcome development; after all, the primary hazard in reorganization cases is the expense of the uncertainties.

Yet there is something very unsatisfying about these decisions. Both courts could have made significant additions to the integrated mosaic of the bankruptcy process; instead, the decisions only add to the hodgepodge of unrelated and uncoordinated "special case" results that have rendered significant portions of the Code virtually unreadable. The issues--and the development of bankruptcy law--deserve better treatment.

II. CASE LAW TREATMENT OF POSTPETITION RENTS

A. Defining the Issue

For the past ten years, practitioners, judges, and commentators have struggled with the application of postpetition rents in the context of an undersecured claim. The issue arises in Chapter 11 cases involving (a) an undersecured creditor, (b) with an income producing property, in which (c) the debtor proposes a plan to retain the property, and (d) invokes the cram down provisions of § 1129(b)(2)(A)(i). To meet the confirmation standard, the plan must provide for payments to the holder of the secured claim "of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in the property." The question arises whether accumulated rents should be included in the value of the secured creditor's interest in the collateral for cram down purposes. Thus, the issue is one subpart of the broader issue of what the Code means when it refers to the "value of such creditor's interest in the estate's interest in such property," in § 506(a) and in § 1129(b)(2)(A)(i)(II). This issue os often determinative in the typical cram down case, because the economics are so close that the Code's requirements can only be met in a narrow range of determined values and payment requirements.

B. The Prior Case Law

A first round of reported decisions considered the statutory provisions, *Timbers* and *Dewsnup* and reached diametrically different conclusions. The disparate results were organized by one court into "Addition Cases" (in which the accumulated rents are added to the value of the property) and "Subtraction Cases" (in which rents are not added to the value of the property, and payment to the secured creditor reduces the amount of the secured claim). *In re Union Meeting Partners*, 178 B.R. 664, 674-75 (Bankr. E.D. Pa. 1995) (Scholl, J.). This classification is helpful, but it understates the diversity of results in the reported cases. For differing reasons (or, as in *Ambanc*, no articulated reason at all), courts have produced at least five different methodologies.

1. The Secured Claim is Determined as of the Effective Date and Rent Payments Reduce the Secured Claim.

In some cases, the secured claim is the value of the real property without including accumulated rents, as of the effective date of the plan. The unsecured claim is then the total claim less the secured claim. Accumulated rent paid to the secured creditor is treated as a payment against the *secured* claim. The plan may provide for a payment holiday while these advance payments are re-allocated to the debt service required by the plan. These cases are one version of the Subtraction Cases. *See, e.g., In re Sherwood Square Assocs.*, 87 B.R. 388 (Bankr. D. Md. 1988); *Matter of IPC Atlanta Ltd. Partnership*, 142 B.R. 547 (Bankr. N.D. Ga. 1992) (Drake, J.); *Confederation Life Ins. Co. v. Beau Rivage Ltd.*, 126 B.R. 632 (N.D. Ga. 1991); *In re B&B West 164th St. Corp.*, 147 B.R. 832 (Bankr. E.D. N.Y. 1992); *In re Creekstone Apartments Assocs., L.P.*, 1995 Bank. Lexis 552 (Bankr. M.D. Tenn. July 20, 1995) (Paine, J.); *In re The Way Apartments, D.T.*, 201 B.R. 444 (N.D. Tex. 1996); *In re Spacek*, 112 B.R. 162 (Bankr. W.D. Tex. 1990).

2. The Secured Claim is Determined as of the Petition Date and Rent Payments Reduce the Secured Claim

In other cases, the secured claim is the value of the real property *as of the petition date*. The unsecured claim is the difference between the total claim and the petition date value of the property. Excess rents paid to the secured creditor during the case reduce the *secured* claim that must be paid in accordance with § 1129(b)(2)(A)(ii). These cases are a second version of the Subtraction Cases. *See, e.g., In re Reddington/Sunarrow Ltd. Partnership*, 119 B.R. 809 (Bankr. D. N.M. 1990); *In re T-H New Orleans Ltd. Partnership*, 188 B.R. 799 (E.D. La. 1995); *In re Embassy North Ltd. Partnership*, 196 B.R. 172 (Bankr. D. Kan. 1996); *In re Kalian*, 169 B.R. 503 (Bankr. D. R.I. 1994); *In re Mullen*, 172 B.R. 473 (Bankr. D. Mass. 1994).

3. The Secured Claim is Determined as of the Effective Date, and Reduced for Hypothetical Disposition Costs; Rents Payments Decrease the Unsecured Claim.

Some courts fix the secured claim at the value of the property on the effective date, less a 10% disposition cost, plus the amount of rent accumulated. The unsecured claim is the difference between the total claim and the value of all collateral at hand on the effective date. *In re Montgomery Apartments*, 141 B.R. 324 (Bankr. S.D. Ohio 1992).

4. The Secured Claim is Determined as of the Effective Date; Rent Payments Reduce the Unsecured Claim.

Other courts hold the secured claim equals the value of the property on the effective date plus the amount of the accumulated rent. The unsecured claim is the difference between the total claim and the value of all collateral. This is the holding of *Ambanc* and the Addition Cases. *See, e.g., In re Flagler at First Assocs. Ltd.*, 114 B.R. 288 (Bankr. S.D. Fla. 1990); *In re Landing Assocs., Ltd.*, 122 B.R. 288 (Bankr. W.D. Tex. 1990); *In re Bloomingdale Partners*, 155 B.R. 961 (Bankr. N.D. Ill. 1993); *In re Gramercy Twin Assocs.*, 187 B.R. 112 (Bankr. S.D. N.Y. 1995); *In re Paradise Springs Assocs.*, 165 B.R. 913 (Bankr. D. Ariz. 1993); *In re Union Meeting Partners*, 178 B.R. 664 (Bankr. E.D. Pa. 1995); *In re Vermont Inv. Ltd. Partnership*, 142 B.R. 571 (Bankr. D. D.C. 1992); *Matter of Homestead Partners, Ltd.*, 200 B.R. 274 (Bankr. N.D. Ga. 1996 (Drake, J.). The Fifth Circuit noted in *T-H New Orleans* that the bankruptcy court had applied the rents to reduce the unsecured portion of the claim but did not reach that issue because it was not raised on appeal (although the outcome of that issue would affect the date on which the secured creditor became entitled to postpetition interest).

5. The Secured Claim is Determined as of the Effective Date; Payments of Rents Are Not Applied to the Secured or Unsecured Claim

Finally, some courts fix the secured claim at the value of the property on the effective date, but treat payments of excess rent during the case as adequate protection payments that do not alter either the secured or unsecured claim. *See, e.g., In re Birdneck Apartment Assocs. II, L.P.*, 156 B.R. 499 (Bankr. E.D. Va. 1993).

6. Additional Variations

Some cases suggest the calculations change depending upon whether the excess rent is paid to the secured creditor during the case or held by the debtor until consummation of the plan. *See, e.g., In re Paradise Springs Assocs.*, 165 B.R. 913, 924-25 (Bankr. D. Ariz. 1993). Other cases suggest the result is affected by the specific language used in the cash collateral order. *In re Birdneck*, 156 B.R. at 505.

In general, debtors argue for a secured claim based only on the value of the property and seek to apply rents to reduce this secured claim. Secured creditors argue for a secured claim based on the aggregate of the property value and the rent. Occasionally, the strategies of the case will cause the parties to switch sides. For example, if accumulated rents would eliminate any deficiency when added to the value of the property and thus eliminate the secured creditor's voting power in the unsecured class, debtors may argue the Addition Cases. *See, e.g., In re Oak Partners*, 135 B.R. 440 (Bankr. N.D. Ga. 1991) (the debtor could apply the rental payments to either the secured or the unsecured claim); *In re B&B West 164th Street Corp.*, 147 B.R. 832 (Bankr. E.D. N.Y. 1992) (deficiency claim constituted over 34% of unsecured claims, thus providing the secured creditor with veto power in that class. Debtor argued that adequate protection payments made during the case would reduce the unsecured claim, thus eliminating the secured creditor's veto power. In granting motion for stay relief, Court concluded, based upon the Subtraction

Cases, that adequate protection payments had to be applied to reduce the secured claim rather than the unsecured claim).

III. THE STATUTORY APPROACH

Contrary to the Fifth Circuit's approach in *T-H New Orleans*, the issue is not, at lest initially, a policy decision for bankruptcy judges to make. Instead, it is an issue of statutory interpretation. The bankruptcy judge's first task is to determine what the Code says.

The Code contains five provisions that are pertinent to the undersecured claim. Section 502 provides general guidance for the determination of all allowed claims. Section 506 instructs that the total claim of the undersecured creditor is divided into a secured claim and an unsecured claim; the amount of the secured claim is the value of the creditor's interest in the debtor's interest in the collateral, and the amount of the unsecured claim is the difference between the total claim and the secured claim. Section 1111(b) permits the secured creditor to elect an alternative calculation of the amount of the secured claim. Section 552(b) provides that the security interest of the creditor attaches to postpetition rents and cash derived therefrom. Section 1129(b) requires that a dissenting secured creditor must receive a payment stream having a present value equal to the secured claim (absent the § 1111(b) election).

As the legislative history and recent cases demonstrate, § 506(a) is designedly non-specific about the use-basis for valuation. *See Associates Commercial Corporation v. Rash*, 65 U.S.L.S. 4451 (June 16, 1997). Whether the valuation question should be answered with a liquidation value, a going concern value, or something else is a matter intentionally left for judicial development. But the debate about rent application is not within this gray area. Instead, the issue hinges on the *date* of the valuation, not the use-basis. Unless the value of the real property declines during the course of the case, the accumulation of excess cash from rents will result in an upward change in the value of the

total collateral package. Cases that add the amount of the rent to the amount of the secured claim are, thus, using a valuation date equal to the effective date of the plan, at which time the accumulated cash exists separately from the real property. *Ambanc* did so explicitly, and *T-H New Orleans* held that valuation could also occur in between those dates if it entitled the secured creditor to interest. Cases that do not add the value of the cash are using a valuation date equal to the petition date, at which time no accumulated rents exist separate from the real property. Both *Ambanc* and *T-H New Orleans* unequivocally reject the petition date valuation, although neither states a clear statutory reason for doing so.

If the Code were silent on the valuation date, the differing answers found in the cases would be a salutary development, reflective of the Code's intent to resolve some issues through case-by-case development. But the Code is not silent on the issue.

A. Section 502 Requires Petition Date Valuation

Section 502(b) explicitly provides that claims are determined as of the petition date. Section 502 is applicable to all claims, including secured claims. Because § 506(a) does not reference any valuation date, one would naturally assume, simply as a matter of statutory interpretation, that the valuation date specified in § 502 controls. Since § 506(a) defines "a secured *claim*" and "an unsecured *claim*," ordinary rules of statutory interpretation require us to interpret each such "claim" to be a "claim" governed and defined by the valuation date language of § 502(b).

This statutory conclusion resolves the dilemma of separately valuing the postpetition rental stream. If the valuation date is the petition date, the rent collected thereafter, and any other appreciation in the value of the collateral, is not considered in valuing the secured claim because it did not exist, at least separately from the real property, as of that date.

This statutory interpretation of § 502(b) and § 506(a) is at odds with the vast majority of cases dealing with the date of valuation for plan purposes, including some Subtraction and all Addition Cases. *See In re Wood*, 190 B.R. 788 (Bankr. M.D. Pa. 1996) (collecting cases and concluding that the Court should pick the valuation date based upon consideration of 11 enumerated factors). A review of these cases reveals, however, that the only reported rent application decision that makes explicit reference to § 502 concludes that the petition date is the appropriate date of valuation of the secured claim under § 506. *In re Embassy Properties North, Ltd. Partnership*, 196 B.R. 172 (Bankr. D. Kan. 1996). The reported decisions concluding that the effective date of the plan is the appropriate valuation date do so simply by not mentioning § 502. For example, *Ambanc* rested solely on interpretation of § 1129(b)(2)(A), and *T-H New Orleans* relied solely on § 506(b); neither mentioned § 502.

Courts adopting the effective date valuation method would view this suggested statutory interpretation as awarding the debtor a "windfall" of the appreciation in value of the property during the administration of the case. But what fundamental bankruptcy principle is offended by the notion that the estate (and all creditors) should benefit from postpetition appreciation, whatever the cause of that appreciation? And where does the Code establish that only the secured creditor should benefit from such appreciation?

The cases suggest that *Dewsnup* (and not the Code) is the origin of the creditor-receives-appreciation principle. While there are many reason to find that *Dewsnup* is inapplicable in reorganization cases, it is more accurate to recognize that *Dewsnup* is simply wrong as statutory interpretation, because there is no language in the Code to support this "principle."

B. SECTION 506(B) PERMITS INTEREST ON UNDERSECURED CLAIMS

If postpetition rents are ultimately paid to the secured creditor on account of its secured claim, these payments would, logically, reduce the amount

of the secured claim, not the unsecured claim. However, because of § 506(b), such rent payments should not result in a dollar-for-dollar reduction in the amount of the secured claim. That section provides:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs of charges provided for under the agreement under which such claim arose.

Section 506(b) focuses on the value of *all* of the collateral but does not expressly state a valuation date for that collateral. Because *this* determination of value is not for purposes of determining the amount of a claim allowable under § 502(b), the petition date instruction in that section is not applicable. The reference to the surcharge provisions of § 506(c) implies that the valuation date for the collateral should be rolled forward to consider developments during administration of the case. These developments would include changes in the value of the underlying property and accumulations of additional collateral in the form of rent to the extent that § 522 provides for a security interest in such postpetition assets.

This statutory interpretation is at odds with all Subtraction Cases and some Addition Cases dealing with the allowance of interest on undersecured claims. In reviewing the reasoning of these decisions, it is clear that these courts consider it an inappropriate "windfall" for undersecured creditors to be awarded interest during the administration of the case. But where does this principle come from?

The cases suggest that *Timbers* (and not the Code) is the origin of the "claims-do-not-change" and "undersecured creditors do not get interest" principle. While there are many reasons to conclude

that *Timbers* is simply wrong statutory interpretation, it is more accurate to conclude that *Timbers* is only about adequate protection and not about claims allowance.

C. No Code Provision Conflicts With Petition Date Valuation

Because a majority of the cases conflict with this initial statutory interpretation, and because § 506 was not redundantly written to include the "petition date" language of § 502, it is appropriate to ask whether this interpretation threatens other provisions of the Code. The potentially conflicting sections are §§ 506(a) itself, 552(b) and 1129(b)(2)(A)(ii).

Many of the Addition Cases refer to § 552(b) and conclude that, to give any meaning to this section, the accumulated rents must be added to the value of the real property to determine the amount of the secured claim. *See, e.g., In re Vermont Inv. Ltd. Partnership*, 142 B.R. 571 (Bankr. D. D.C. 1992); *In re Bloomingdale Partners*, 155 B.R. 961, 976 (Bankr. N.D. Ill. 1993) ("Not counting Hancock's post-petition security interest in rents would render § 552(b) 'a practical nullity and theoretical absurdity.'"). This is a misreading of the section based upon a misunderstanding of its purpose. Section 552(B) identifies postpetition property to which a creditor's security interest attaches. Nothing in this section suggests that the rent to which the security interest attaches must be included in determining the amount of the secured claim; § 552(b) means only that the secured claim--determined in accordance with § 506 is secured by both the petition date property and the postpetition rent. *See In re Creekstone Apartments Assocs., L.P.*, 1995 Bankr. Lexis 552 (Bankr. M.D. Tenn. January 20, 1995) (Paine, J.) ("That an undersecured creditor may retain its security interest in rents under § 552(b) does not lead to the conclusion that those rents enhance the creditor's secured claim. Rather retention of the lien allows only for those rents to be applied against the lender's secured claim, lest we render § 506(b) and *Timbers* meaningless.")

Other courts have found the specific reference to the "effective date" in § 1129(b)(2)(A)(ii) controls the valuation date. *See In re Landing Assocs., Ltd.*, 122 B.R. 288 (Bankr. W.D. Tex. 1990). For example, *Ambanc* arrived at its valuation date by holding that § 1129(b)(2)(A)(i) requires "deferred cash payments equal to the present value at the effective date." 115 F.3d at 654. Similar references have been made to the "effective date" language in § 1129(a)(7). While these sections do speak of value as of the effective date, the reference is clearly to the value of the payment stream under the plan, not the value of the collateral. They require the *payment stream* to be present valued as of the "effective date" but do not specify a valuation date for the *collateral*. *See In re Embassy Properties North*, 196 B.R. at 177. When this section speaks of the value of the collateral, it uses exactly the same phraseology used in § 506(a). As a general rule, statutory interpretation requires that the same phrase has the same meaning in different provisions of the same Code.

Many courts have found the language of § 506(a) itself to require effective date valuation. The specific language relied upon is as follows:

> Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

If no other provision of the Code spoke to the valuation date, this language would imply that at least one appropriate valuation date is the date of the valuation hearing. But since § 502(b) does provide a valuation date, statutory interpretation requires an effort to harmonize both sections.

Harmony can easily be achieved if we consider the variables in every appraisal. One variable is the valuation date, but another important variable is the use of the property. Ordinarily, an appraiser determines and then employs "the highest and best

use of the property." The most natural reading of the quoted portion of § 506(a) is that "highest and best use" is not applicable for claims determination purposes. Instead, the value should be based upon the actual use intended by the plan proponent, whether that is to sell the property, hold it, or develop it, regardless of the highest and best use. Since this portion of § 506(a) says nothing about the *date* of the valuation, the provisions of § 502(b) still control the valuation date.

D. PETITION DATE VALUATION IS SUPPORTED BY LEGISLATIVE INTENT

As *Dewsnup* illustrates, courts do not always feel constrained to apply strict rules of statutory construction in answering bankruptcy questions. At any point in time, a majority of the Supreme Court may find it appropriate to search for Congressional intent beyond the language of the Code. Unfortunately, the Court does not speak with one voice as to just how that search should be conducted.

1. The Scalia Approach

Justice Scalia's intent search is the most restrictive. Justice Scalia scorns virtually all legislative history and limits his search to a purely logical inquiry whether a particular interpretation is so silly as to be presumptively unintended. His *Timbers* opinion illustrates this approach. In rejecting the argument that the interest of a creditor entitled to adequate protection includes the right to immediate possession, Justice Scalia states:

> In subsection (a) of [§ 506] the creditor's "interest in property" obviously means his security interest without taking account of his right to immediate possession of the collateral on default. If the latter were included, the "value of such creditor's interest" would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues--since the value of the entitlement to use the collateral from the date of bankruptcy would

> rise with the passage of time. *No one suggests this was intended* (emphasis supplied).

The problem with this approach to statutory interpretation is that the relative silliness of possible Congressional intentions can be determined only by reference to some general notion of what Congress was attempting to do. Any court that eliminates an otherwise feasible reading of the Code on the basis that "Congress could not have meant this," does so based on that court's usually unarticulated assumptions about the purposes and underlying principles. The flaw in this approach is evident in our rents example.

Many bankruptcy courts faced with the rent application issue have concluded what, according to Justice Scalia, no one could conceivably have intended--that the amount of the secured claim changes during the case, on account of appreciation or depreciation. This is in fact what the Fifth Circuit held in *T-H New Orleans*. So much for Justice Scalia's "no one suggests this was intended."

But there are other possible "intentions" here. Congress may have intended, as Justice Scalia implied, that the amount of the secured claim would *not* vary during the case. There are at least two other possibilities: Congress intended for the courts to decide, on a case-by-case basis, whether the amount of the secured claim should vary; or, Congress did not consider the question.

It is difficult to eliminate any of these hypotheses of Congressional intent using solely the pure logic approach promoted by Justice Scalia. Each of the possibilities is feasible. We will have to dig deeper.

2. The Prior Law Approach

A second, and somewhat broader, approach to Congressional intent is to assume that Congress did not intend a significant change in bankruptcy law, or a significant alteration of property rights

within bankruptcy, unless that intent was clearly expressed. This approach requires analysis of the law prior to adoption of the Code.

With respect to whether a secured claim should be determined on the petition date or the effective date, analysis of prior law is of virtually no value. First, the history of the Code, from the Commission Report in 1973 through the Senate Report and House Report, amply demonstrates that the Code was intended to produce a completely new perspective on the rights and interests of the secured creditor. The Act dealt with secured *creditors*; the Code was designed to deal with secured *claims*. The bifurcation of the claim of the secured creditor was intended to redefine and alter the rights of the undersecured creditor based upon the economic realities of the case. Whatever resolution of the issue of valuation date might be found in prior law, the clearly expressed congressional intent was that the rights of a secured creditor would be altered under the Code.

Secondly, prior law is inconclusive because prior reorganization law had no parallel concept to reducing the claim of the secured creditor based upon collateral valuation--without regard to valuation date. In Chapter XI cases, secured creditors and secured claims were, at least theoretically, unaffected. In Chapter X cases, the absoluteness of the absolute priority rule prevented any reallocation of rights and benefits until superior classes were paid in full. Since the Act contained no concept of bifurcating the claim of the secured creditor, the existence, and therefore the amount, of a deficiency in the value of collateral was immaterial.

3. The Legislative History Approach

The least desirable method of ascertaining legislative intent, according to the Supreme Court, is looking at the legislative history itself. There, finally, we find some indications that Congress understood that the amount of the secured claim would be determinable at or near the commencement of the case and would thereafter not be

subject to change. The House Report contains the following passage:

> The new treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims, has important protective consequences for both creditor and debtor. For the creditor, the bill requires that once the secured claim is determined, the court must insure that the holder of the claim is adequately protected. The secured creditor is entitled to realize his claim, and not have his collateral eroded by delay or by use by the estate. For the debtor, the determination of the amount of the secured claim facilitates reorganization in the business context, and repayment plans in the consumer context, by defining the precise extent of the claims against the debtor that must be treated as secure claims. . . .
>
> Because of the uncertain treatment of secured creditors under current law, the debtor is often required to err on the side of overprotection when formulating a reorganization or repayment plan. Secured creditors have exercised great leverage by virtue of the uncertainty, and have made reorganization and individual repayment plans more difficult to consummate than would be the case under the bill. Since a successful reorganization or chapter 13 plan inures to the benefit of all creditors, the change under the bill should increase recoveries by creditors generally.

This portion of the House report is not conclusive evidence of congressional intent to determine value as of the petition date; in can be read consistently with any valuation date before confirmation of the plan. However, this portion of the Report is most comfortably read to contemplate a reorganization case that starts with valuation, then moves to adequate protection based on that valuation, then moves to plan formulation based on that valuation. This implied sequencing is

consistent with a single valuation and consistent only with valuation as of the petition date.

The House Report discussion of a balancing of benefits is most consistent with determining secured claims as of the petition date. The House Report implies that the secured creditor is entitled to the benefit of its secured claim, once determined, without diminishment. It is difficult to read this passage without assuming that Congress intended to treat the secured claim as fixed on the petition date, not subject to reduction on account of delay or use (depreciation or market variations). If the treatment of a secured claim would not be reduced because of a decline in value of the collateral during the case, balance is served by a rule that the treatment of a secured claim is not enhanced by an increase in the value of collateral (except to the extent that 506(b) so provides).

The legislative history is informative on another aspect of the rent application controversy. As discussed above, some courts and commentators have found that, regardless of § 506(a), § 1129(b)(2)(A)(i)(II) establishes a different mark for the treatment of secured claims in a Chapter 11 plan. These courts suggest that the requirement that the payment stream have a present value "as of the effective date of the plan" invites a confirmation date valuation of the collateral rather than a petition date valuation. The legislative history indicates otherwise.

In the version of HR 95-595 initially passed by the House, this language did not appear. Instead, this version contained the language "equal to the allowed amount of such claim." The language was changed only when § 1111(b) was added by the Senate-House conference. Floor statements regarding this amendment explain that, when no § 1111(b) election is made, the lien is retained "only to the extent of their allowed secured claims," and the present value of the payment stream must be "equal to the allowed secured claim which in turn is only the equivalent value of the collateral under section 506(a)." Floor Statements, Statement of Rep. Edwards, H. 11104, Sept. 28, 1978.

This little gem from the legislative history also contains an intriguing example to explain the workings of § 1111(b):

> For example, if a creditor loaned $15,000,000 to a debtor secured by real property worth $18,000,000 and the value of the real property had dropped to $12,000,000 *by the date when the debtor commenced a proceeding under Chapter 11*, the plan could be confirmed notwithstanding the dissent of the creditor as long as the lien remains on the collateral to secure a $15,000,000 debt, the face amount of present or extended payments to be made to the creditor under the plan is at least $15,000,000, and the present value of the present or deferred payments is not less than $12,000,000. (Emphasis added). *Id.*

4. The Floating Valuation Problem

There is one part of the legislative history and of § 506(a) that has been interpreted by some courts as a clear command to employ a traveling valuation date. Section 506(a) of the Code states that the valuation "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." The legislative history indicates that this language was not in the original House version but was added by the Senate. The Senate Report states:

> To illustrate, a valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan.

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The floor statements explain the adoption of the Senate language:

> [A] determination of what portion of an allowed claim is secured and what portion is unsecured is binding only for the purpose for which the determination is made. Thus determinations for purposes of adequate protection is [sic] not binding for purposes of "cram down" on confirmation in a case under Chapter 11. Statement of Rep. Edwards, H 11095, Sept. 28, 1978.

This language easily succumbs to three different interpretations. First, the provision may only be a procedural instruction, indicating that valuation determinations at the beginning of the case will have no *stare decisis* effect. Second, the provision may be an acknowledgement that value with fluctuate with the basis upon which the valuation is made, *i.e.* liquidation, retention, going concern value. Finally, the provision may mean that value changes during the course of the case.

While the procedural interpretation is tempting, it is probably not accurate. Given the circumstances prevailing during the Code's adoption phase, the second reading seems much more likely. The most significant changes being made in bankruptcy law related to the combination of Chapter X and Chapter XI. Congress was acutely aware of the very differing approaches to valuation then being used for Chapter X absolute priority determinations (going concern value) and for Chapter XI best interest determinations (liquidation value). The most likely meaning of the Code provision and legislative statement is that Congress assumed that liquidation value would be pertinent for adequate protection issues during administration of the case and going concern valuation would or might be used for allowance and plan confirmation purposes.

The third possible interpretation--that Congress meant to include appreciation or depreciation of property during the case in the allowed amount of the secured claim--seems least likely. While it is always risky to infer much from silence, the absence of any reference to the date of valuation, in contrast with the specific references to the purpose of the valuation and the proposed use of the

property, suggest that Congress was not focused on the effect of the passage of time on the value of collateral.

5. Could Congress Have Ignored the Possibility of Appreciation?

It is also possible that Congress overlooked the impact of appreciate or depreciation on the amount of allowable claims, and, thus, had no intended resolution of its treatment. This possibility is enhanced by the impression, discussed in *Timbers*, that the paradigm successful Chapter 11 case envisioned by Congress would be fully processed within the period of debtor's exclusivity. With this view, Congress may have thought that inflation would be a minimal factor.

But I do not think so. When the Code's language was being forged (1973 through 1978) interest rates rose to 15% and inflation rose to 18%. A 10% change in value during even a six-month reorganization--due solely to inflation--was a real prospect.

6. Conclusions About Congressional Intent

The legislative history does not compel the conclusion that Congress intended to preserve appreciation for the exclusive benefit of the secured creditor. While the legislative history does support the notion that bankruptcy courts may determine value more than once during a case, that same history indicates that the need for different valuations would arise because the issue presented would change (*e.g.*, adequate protection versus claims allowance) or because the proposed use of the property might be different in one plan versus another. There is nothing in the legislative history that indicates a Congressional focus on the possibility of appreciation.

The legislative history does demonstrate that Congress intended--for the benefit of creditors and debtors alike--that the allowance of a secured claim could be fixed prior to confirmation so that the creditor would know the adequate protection to which it was entitled and so that the debtor would know

the numbers necessary to develop a plan. It is difficult to imagine how these two articulated objectives can be met if the amount of the secured claim changes during the case based upon an ever moving valuation date.

IV. CHAPTER 11 AS A DYNAMIC BARGAINING PROCESS

A number of courts have recently engaged in Code interpretation by analyzing the impact on the bargaining dynamics of reorganization cases. For example, the Seventh Circuit, in *In re Hoskins*, 102 F.3d 311, 316 (7th Cir. 1996), interpreted § 506(a) in light of the bargaining process between the parties:

> There is no way to predict where in the bargaining range the bargain would be struck. But to economize on bargaining costs, people who find themselves in a bilateral monopoly situation will often agree simply to split the difference. The midpoint is what game theorists call a "focal point," a natural point to which bargaining parties will gravitate if they don't want to waste a lot of time in bluffing and haggling. See, e.g., Douglas G. Baird, Robert H. Gertner & Randal C. Picker, Game Theory and the Law 39 (1994). So the midpoint of the bargaining range, which is the point that the bankruptcy court chose in this case, is a reasonable approximation of the likely average valuation of the debtor's automobile that the secured creditor and defaulting debtor would agree upon (were there no Chapter 13) in the type of situation for which Chapter 13 was designed--the insolvency of an individual debtor with a regular income. Since it is desirable to have a rule for determining value in these low-value cases rather than a flabby standard, and since the midpoint rule is superior from the standpoint of the underlying economics of the situation to either of the alternative rules--wholesale value or retail value--we hold that in Chapter 13 cases involving automobiles and similar assets used to produce income for the

debtor the value of the secured interest is the average of the retail and the wholesale value of the collateral.

Similarly, the bankruptcy court in *In re Addison Properties, Ltd. Partnership*, 185 B.R. 766 (Bankr. N.D. Ill. 1995), analyzed the impact of the Addition Cases and Subtraction Cases on the bargaining process, concluding that, "The practical consequence of single valuation [meaning petition date valuation] is to balance the bankruptcy process in favor of the debtor . . .", and that "the effect of continuous valuation [meaning effective date valuation] is to balance the bankruptcy process heavily in favor of the creditor. . . ." *Id.* at 733, 777.

Code interpretation designed solely to promote bargaining (or create bargaining balance) is a slippery slope. There are, after all, *some* identifiable bankruptcy polices. A no-rule, equal-bargaining-position approach is not likely to promote known policies. Moreover, if there are no rules, parties are less likely to achieve a bargain.

Despite these shortcomings, consideration of the impact on bargaining process ought to be part of Code interpretation because Chapter 11's are mostly about bargaining. The Code's specific provisions perform two functions: First, usually in a very general and dynamic way, the Code spells out fundamental objectives of bankruptcy and reorganization law. Within this framework, the Code's reorganization provisions promote constructive bargaining by interested parties to reach expeditious results consistent with the general objectives.

Several insights arise from this perspective on the Code. First, particularly in reorganization cases, there are "multiple right answers," that is, results that equally (or sufficiently) serve the general objectives of the Code. Mark MacDonald, et al., *Chapter 11 as a Dynamic Evolutionary Learning Process in a Market With Fuzzy Values*, at 10 (Monograph). While practitioners may innately understand this conclusion, they may not readily

accept its corollary in Code interpretation--the policies underlying the Code may be indifferent to which answer is chosen, provided that overall and general objectives are achieved.

This insight leads to a second: the Code's language may require a particular answer to a particular question not because it achieves overall substantive objectives but because it promotes constructive bargaining at the "right time." Surely, this is the case with the most of the Code's flexible timing provisions (such as the exclusivity period or the time to assume, reject or seek more time to decide on non-residential real property leases).

Applying these insights to the rent application issue tempts us with these conclusions:

1. Whether petition date or effective date is used as a benchmark for property value is unimportant to any substantive objective of the bankruptcy laws. In a universe of multiple right answers, both are right.

2. The selection of a valuation date does affect behavior of the parties during reorganization cases.

a. If effective date valuation is used, the undersecured creditor is incentivized to delay administration of the case (an undesirable change in the bargaining positions of the parties) if the value of its collateral is growing.

b. If effective date valuation is used, the debtor or trustee is disincentivized to enhance the value of the estate (an undesirable change in the bargaining positions of the parties) during administration of the case, because the benefits of enhancement simply increase the hill the debtor must climb.

c. If petition date is used and no interest accrues, the secured creditor is highly motivated to a quick end to the case (sometimes, an undesirable change in the bargaining position of

the parties) because its position can only deteriorate with the passage of time.

d. Conversely, if petition date is used and no interest accrues, the debtor or trustee is highly motivated to stretch administration of the case (always an undesirable change in the bargaining position of the parties), because its cash position continues to strengthen.

e. If petition date is used and interest accrues on the claim, the secured creditor's position is neutral on both the timing of the case and the possibility of appreciation of the collateral.

f. If petition date is used and interest accrues on the claim, the debtor is incentivized to enhance the value of the property but is not incentivized to stretch out administration of the case.

3. Choosing the petition date as the valuation date and permitting interest to accrue serves the overall objectives of reorganization cases by both promoting optimization of distributable values (since it incentivizes the debtor to enhance the value of its property) and by neutralizing the bargaining position impact of the passage of time during administration of the case.

V. *AMBANC* AND THE DEVELOPMENT OF BANKRUPTCY LAW

We cannot read the legislative history of the Code without noting the importance that the drafters placed on the dynamic development of the law through case-by-case decision. Part of the majesty of the Code derives froyym this process.

With respect to rent application, this process has been well under way for ten years. We had initial disparate decisions at the bankruptcy court level. Commentators weighed in, but no consensus emerged. A second round of bankruptcy court decisions re-evaluated and criticized the first round, but still no "right answer" emerged. What was supposed to happen next was meaningful appellate

review: a circuit court decision collecting conflicting reasoning and disparate results and synthesizing a compelling statutory interpretation.

Something interrupted the process. We have our appellate decision, but without reasoning and without even a citation to a bankruptcy court decision that contains reasoning. For those outside the Ninth Circuit, *Ambanc* is a non-event.

For those in the Ninth Circuit, *Ambanc* is worse. While it may resolve a particular issue in some cases, it does so at a high cost--separation of bankruptcy law from both its historical origins and the language of the Code. The *Ambanc* methodology promotes a belief that bankruptcy law is "found" in largely unarticulated notions of the correlative rights of debtor, secured creditor and unsecured creditor. *Ambanc* says that the debtor's plan fails because the debtor overreached and invaded protected interests of the secured creditor. *Ambanc* offers no hint how the debtor should have known of the interests that it transgressed.

The Code and bankruptcy system deserve better.

Editor's Comment

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Mr. Ashworth's statutory analysis and legislative history surpasses anything found in the case law. He is certainly correct that the heart of the issue is the selection of valuation date(s), and that this issue is purely one of statutory construction, rather than a policy decision that Congress left to judges based on the facts before them. He also makes a convincing argument that neither the language of § 506(a) nor § 1129(b)(2)(A)(i) specifically requires an effective date valuation.

But ultimately I am not convinced that § 502 mandates a petition date valuation. First, it only addresses the total amount of the claim, not how it is split into secured and unsecured portions, which is controlled solely by § 506. Second, it must be agreed that the amount of a secured claim *may* vary during a case notwithstanding § 502, because payments made on a secured debt during the case must affect the total amount of claim that must be satisfied pursuant to § 1129(b)(2)(A) (either the principal or the accrued interest). This recognition damages Mr. Ashworth's argument, because if the language of § 502 does not prevent adjustment of the amount of the claim due to payments made, it similarly does not prevent adjustments based on variations in the value of the collateral.

If the language of § 502 does not always require a petition date valuation, then the language of § 506(a) that suggests the date of the valuation hearing is the best answer the Code provides, as Mr. Ashworth essentially admits. This conclusion means that nay accumulated rents must be added to the value of the real property to determine the amount of the secured claim, whenever such a valuation is made during the course of a case. It avoids the anomaly of an undersecured claim becoming "oversecured" (and accruing interest) solely due to accumulation of rents, while the total claim still

exceeds the total collateral value. It also means that both *Ambanc* and *T-H New Orleans* reached the right results, albeit without adequately articulated reasons.